Supreme Court, U.S.
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No. 07-___

IN THE

Supreme Court of the United States

FIRST COMMAND FINANCIAL PLANNING, INC.; FIRST COMMAND FINANCIAL SERVICES, INC.; LAMAR C. SMITH; AND HOWARD M. CRUMP,

Petitioners,

v.

MICHAEL MCPHAIL; ROBERT BARR KIMNACH III; KEVIN AND JENNIFER MORRISON; SCOTT AND KRYSTIN WAGNER; CANDACE AND NEIL HURLEY; ON BEHALF OF THEMSELVES AND ALL OTHERS SIMILARLY SITUATED,

Respondents.

On Petition for Writ of Certiorari to the United States Court of Appeals for the Ninth Circuit

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PETITION FOR WRIT OF CERTIORARI

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QUESTION PRESENTED

The question presented is:

This Court has consistently held that class actions are purely procedural devices that, under the Rules Enabling Act, cannot alter substantive rights of class members and defendants. This Court has also held that although "reliance" is an element of a claim for securities fraud under Rule 10b-5, where the claim involves the price of securities traded in an "open . . . [and] well developed" securities market, a "rebuttable presumption" of reliance exists.

In this case, relying on recent Ninth Circuit authority (consistent with Third Circuit authority, but contrary to First, Second, Fourth, Fifth, Sixth, and Seventh Circuit authority), the district court certified a class under Rule 10b-5 even though the case does not involve the market price of a publicly traded security, reasoning that "uniform" representations alone are sufficient to create a presumption of reliance. The Ninth Circuit declined to review this decision under FED. R. CIV. P. 23(f).

The question presented is whether the class certification ruling is so manifestly erroneous, under the Rules Enabling Act, the Seventh Amendment, and this Court's decisions on reliance and commonality, that the Ninth Circuit clearly abused its discretion in declining to review it under FED. R. CIV. P. 23(f).

PARTIES TO THE PROCEEDING AND RULE 29.6 STATEMENT

There are no parties to this proceeding other than those identified in the caption.

Pursuant to Rule 29.6 of the Rules of the Supreme Court of the United States, Petitioners First Command Financial Planning, Inc. and First Command Financial Services, Inc. state that they have no parent corporations or corporate stockholders with holdings in excess of 10% (except that Petitioner First Command Financial Services, Inc. is the parent corporation of Petitioner First Command Financial Planning, Inc.).

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PETITION FOR WRIT OF CERTIORARI

First Command Financial Planning, Inc. ("First Command"), First Command Financial Services, Inc., Lamar C. Smith and Howard M. Crump respectfully petition for a writ of certiorari to review the denial of their Petition under FED. R. CIV. P. 23(f) by the United States Court of Appeals for the Ninth Circuit.

OPINIONS BELOW

The court of appeals' denial of en banc reconsideration (App. A), dated November 1, 2007, is not

reported. The court of appeals' Order denying the petition under Rule 23(f) (App. B), dated September 14, 2007, is not reported. The district court's Order granting class certification (App. C) is found at *McPhail v. First Command Fin. Planning, Inc.*, No. 05CV179 IEG (JMA), 2007 WL 2207761 (S.D. Cal. Jul. 30, 2007).

STATEMENT OF JURISDICTION

The court of appeals' Order was entered on September 14, 2007. The court of appeals denied en banc reconsideration on November 1, 2007. This Court's jurisdiction is invoked under 28 U.S.C. § 1254(1).

CONSTITUTIONAL AND STATUTORY PROVISIONS INVOLVED

The Due Process Clause of the Fifth Amendment to the United States Constitution provides, in part, that "[n]o person shall be . . . deprived of life, liberty, or property, without due process of law." U.S. CONST. amend. V.

The Seventh Amendment to the United States Constitution provides, in part, that "[i]n Suits at common law . . . the right of trial by jury shall be preserved." *Id.* amend. VII.

The Rules Enabling Act provides, in part: "Such [procedural] rules shall not abridge, enlarge or modify any substantive right." 28 U.S.C. § 2072(b).

Rule 10b-5 provides, in part: "It shall be unlawful for any person, directly or indirectly, . . . [t]o make any untrue statement of a material fact or to omit to state a material fact . . . in connection with the purchase or sale of any security." 17 C.F.R. § 240.10b-5 ("Rule 10b-5").

FED. R. CIV. P. 23(b)(3) ("Rule 23(b)(3)") provides, in part, as one of the requirements for class certification, that "questions of law or fact common to the members of the class [must] predominate over any questions affecting only individual members."

FED. R. CIV. P. 23(f) ("Rule 23(f)") provides, in pertinent part, that "[a] court of appeals may in its discretion permit an appeal from an order of a district court granting or denying class certification."

The full text of these provisions is set forth in the Appendix (App. D-H).

STATEMENT OF THE CASE

This is a securities fraud case brought under Section 10 of the Securities Exchange Act of 1934, 15 U.S.C. § 78j, and Rule 10b-5 promulgated thereunder, alleging misrepresentations in the sale of mutual funds. Federal question jurisdiction exists in the trial court under 28 U.S.C. § 1331 and Section 27 of the Securities Exchange Act of 1934, 15 U.S.C. § 78aa.

Petitioner First Command is a securities broker-dealer with a network of several hundred registered representatives who sell mutual funds and provide other financial services. Respondents claim that First Command caused its representatives to make misrepresentations about mutual fund sales charges. There is no allegation relating to the market price or performance of any mutual fund. The representations in question were made in meetings between hundreds of First Command representatives and thousands of individual investors.

The trial court certified a class of persons who purchased mutual funds through First Command repre-

sentatives and paid allegedly excessive sales charges. Petitioners opposed class certification on a variety of grounds, principally that (1) individual issues of reliance predominated over common issues, and (2) certification of a class would violate the Rules Enabling Act, the Seventh Amendment, and the Due Process Clause by depriving Petitioners of the ability to present individual reliance defenses. The Ninth Circuit denied a Petition for review under Rule 23(f) (App. B) and denied a Petition for reconsideration en banc (App. A).

REASONS FOR GRANTING CERTIORARI

The Ninth Circuit's denial of the Petition under Rule 23(f) resulted in a class-wide proceeding that significantly departs from the accepted and usual course of judicial proceedings, magnifies an already mature split between the circuits on an important securities litigation issue, and deprives Petitioners of jury trial rights.[1]

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[1] The Court may grant certiorari when a "United States court of appeals . . . has so far departed from the accepted and usual course of judicial proceedings, or sanctioned such a departure by a lower court, as to call for an exercise of this Court's supervisory power." SUP. CT. R. 10(a). The Court can review an exercise of discretion below if there is a "strong suggestion of an abuse of that discretion" or if there are issues of "sufficient general importance" to justify a grant of certiorari. *United States v. Nobles*, 422 U.S. 225, 241 n.16 (1977) (rejecting, in the absence of these factors, to consider the trial court's decision in excluding expert testimony). Further, the Court has been "vigilant to exercise its power of review in any case where it appears that the litigants have been improperly deprived of [the right to a jury] determination." *Rogers v. Mo. Pac. R.R. Co.*, 352 U.S. 500, 509 (1957) (considering whether the Missouri Supreme Court "invaded" the jury's function in action under Federal Employer's Liability Act).

This Court has repeatedly held that reliance is an element of a claim under Rule 10b-5. *Basic Inc. v. Levinson*, 485 U.S. 224, 243 (1988) ("We agree that reliance is an element of a Rule 10b-5 cause of action.") (citing *Ernst & Ernst v. Hochfelder*, 425 U.S. 185, 206 (1976) (quoting Senate Report)); *Dura Pharms., Inc. v. Broudo*, 544 U.S. 336, 341-42 (2005). In *Basic*, the Court permitted a rebuttable presumption of reliance in cases involving securities traded on the "open . . . [and] well developed" securities markets because investors are presumed to rely on the integrity of stock prices set by the market (known as the "fraud-on-the-market" presumption). 485 U.S. at 246-47.[2] The Court stated:

> An investor who buys or sells stock at the price set by the market does so in reliance on the integrity of that price. Because most publicly available information is reflected in market price, an investor's reliance on any public material misrepresentations, therefore, may be presumed for purposes of a Rule 10b-5 action.

Id. at 247. The Court specifically stated that if individual reliance were required, a class could not be certified "since individual issues then would have overwhelmed the common ones." *Id.* at 242.[3]

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[2] As shown below, this Court's formulation requiring an "open . . . [and] well developed" market has resulted in an accepted body of law in several circuits requiring an "efficient market" for the *Basic* presumption to apply.

[3] The *Basic* "presumption of reliance" is rebuttable. 485 U.S. at 250. In cases involving the market price of a security, rebuttal of the presumption of reliance can occur by showing that other information entered the market and affected the stock price. *Id.* at 248-49. However, where (as here) the case involves sales charges and contract terms (and not the market price of a publicly traded security), the only realistic way to "rebut" the presumption of reliance would be based on evidence of what

I. The Circuit Split on the *Basic* Presumption.

The First, Second, Fourth, Fifth, Sixth and Seventh Circuits have adopted the *Basic* presumption of reliance (allowing class certification) in Rule 10b-5 cases only where the case involves the market price of a stock traded on an "open . . . [and] well developed" securities market. In contrast, the Third and Ninth Circuits have permitted "uniform" representations alone to give rise to a presumption of reliance—even where the case does not involve the market price of a security. The Tenth Circuit has been ambivalent on the issue.

Second Circuit. In *In re Initial Pub. Offerings Sec. Litig.*, 471 F.3d 24, 43 (2d Cir. 2006), the Second Circuit, in vacating class certification as to several IPO's, held that "[w]ithout the *Basic* presumption, individual questions of reliance would predominate over common questions." The Second Circuit noted that because an IPO involves newly issued securities, there is no efficient market for its shares. *Id.* at 42-43. In every IPO, a "uniform" prospectus is given to investors. Thus, *a fortiori*, uniformity does not equate to reliance in the Second Circuit. Indeed, the Second Circuit had previously ruled—contrary to the Ninth Circuit—that because of the reliance requirement, uniform representations are insufficient to meet the predominance requirement of Rule 23(b)(3). *Cf. Moore v. PaineWebber, Inc.*, 306 F.3d 1247, 1255 (2d Cir. 2002) ("[A] common course of conduct [in a RICO/fraud action] is not enough to show predominance, because a common course of

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each individual investor actually relied on. Such evidence is not available in a class proceeding.

conduct is not sufficient to establish liability of the defendant to any particular plaintiff.").

Fifth Circuit. The Fifth Circuit has not only followed *Basic*, but it has also "tightened" the standards for a presumption of reliance by rejecting this presumption unless the false statement actually moved the market. *Oscar Private Equity Invs. v. Allegiance Telecom, Inc.*, 487 F.3d 261, 262, 264-65 (5th Cir. 2007) ("Essentially, we require plaintiffs to establish loss causation in order to trigger the fraud-on-the-market presumption.").[4] The Fifth Circuit has also required that a plaintiff demonstrate the applicability of the presumption of reliance "by a preponderance of all admissible evidence." *Id.* at 269. Thus, the law in the Fifth Circuit is the polar opposite of the Ninth Circuit.

Fourth Circuit. In *Gariety v. Grant Thornton LLP*, 368 F.3d 356, 364 (4th Cir. 2004), defendant Grant Thornton prevailed on its contention that "[w]ithout [the *Basic*] presumption, the plaintiffs must prove individualized reliance and therefore almost certainly cannot meet the requirement of [Rule] 23(b)." The Fourth Circuit added that the trial court must conduct an evidentiary hearing and must determine *actual* market efficiency before certifying a class under Rule 10b-5. *Id.* at 367. Such efficiency may not be assumed or presumed, even if the stock is publicly traded. *Id.* at 367-68. The Fourth Circuit held that in cases involving "face-to-face" transactions (such as the instant case), the individual

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[4] The Fifth Circuit also noted in *Oscar*: "[T]he efficient market doctrine facilitates the extraordinary aggregation of claims. We cannot ignore the *in terrorem* power of certification." 487 F.3d at 267.

reliance requirement serves an important legal function. *Id.*[5]

First, Sixth, and Seventh Circuits. The First, Sixth, and Seventh Circuits have also required a showing of market efficiency under *Basic* in order to create a presumption of reliance. *See, e.g., In re Polymedica Corp. Sec. Litig.*, 432 F.3d 1, 7-8 (1st Cir. 2005); *Freeman v. Laventhol & Horwath*, 915 F.2d 193, 197-98 (6th Cir. 1990); *West v. Prudential Sec., Inc.*, 282 F.3d 935, 937-38 (7th Cir. 2002) (addressing the "public information" component of the market efficiency determination under *Basic*).[6]

Third Circuit. In contrast, the Third Circuit has joined the Ninth Circuit in allowing a presumption of reliance in a Rule 10b-5 case based on uniformity, rather than requiring compliance with *Basic*. *See Newton v. Merrill Lynch, Pierce, Fenner & Smith, Inc.*, 259 F.3d 154, 176-77 (3d Cir. 2001) ("Presuming reliance class-wide is proper when the material nondisclosure is part of a common course of conduct." (citing *Hoxworth v. Blinder, Robinson & Co.*, 980

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[5] In *Cent. Bank of Denver v. First Interstate Bank of Denver*, 511 U.S. 164, 180 (1994) ("*Central Bank*"), the Court observed that one of the reasons for the rule enunciated in that case was to prevent plaintiffs from "circumvent[ing] the reliance requirement."

[6] The Tenth Circuit appears to be mixed on this issue. In *Joseph v. Wiles*, 223 F.3d 1155, 1164 n.2, 1166 (10th Cir. 2000), the Tenth Circuit recognized the fraud-on-the-market theory under *Basic*, dismissing plaintiff's claim under 10b-5 because he was "not entitled to any presumption of reliance." However, in *T.J. Raney & Sons, Inc. v. Fort Cobb, Okla. Irrigation Fuel Auth.*, 717 F.2d 1330, 1332-33 (10th Cir. 1983), that circuit allowed a presumption of reliance even though the traditional fraud-on-the-market theory (in which "developed securities are actively traded") did not apply to defendants' newly issued bonds.

F.2d 912, 924 (3d Cir. 1992) ("*Hoxworth II*")));
Hoxworth v. Blinder, Robinson & Co., 903 F.2d 186, 202 (3d Cir. 1990) ("*Hoxworth I*") (holding that the district court did not err "in excusing plaintiffs from their burden of proving reliance on those nondisclosures and half-truths");[7] *see also Johnston v. HBO Film Mgmt., Inc.*, 265 F.3d 178, 193-94 (3d Cir. 2001) (distinguishing *Hoxworth I* and *Sharp v. Coopers & Lybrand*, 649 F.2d 175 (3d Cir. 1981), and rejecting a presumption of reliance in a RICO suit because there was no evidence of a "uniform sales pitch or uniform representations").

In *Newton*, the Third Circuit said:

> Reliance may be presumed when a fraudulent misrepresentation or omission impairs the value of a security traded in an efficient market. . . . Here plaintiffs' claims do not involve an omission or misrepresentation that affected the value of a security in an efficient market. Therefore, a presumption of reliance based on this theory would be inappropriate.

259 F.3d at 175-76 (citations omitted). Despite this, the Third Circuit held:

> When defendants fail to disclose material information about a uniform practice involving the purchase or sale of securities, plaintiffs may be entitled to a presumption of reliance which defendants may rebut. . . . Presuming reliance class-wide is proper when the material

[7] While Third Circuit decisions, such as *Hoxworth I* and *Hoxworth II*, tend to blend a finding of "uniformity" with the *Affiliated Ute* presumption (see *infra*, note 10), the Third Circuit looks to "uniformity" as an essential mooring for a presumption of reliance.

> nondisclosure is part of a common course of conduct. *Hoxworth II,* 980 F.2d at 924.

Id. at 176-77 (parenthetical and additional citations omitted).[8]

Ninth Circuit. In line with the Third Circuit, but contrary to the First, Second, Fifth, Sixth, and Seventh Circuits, the Ninth Circuit has allowed certification of a class without the *Basic* presumption, based on "uniform" representations. *See In re First Alliance Mortgage Co.*, 471 F.3d 977, 990, 991-92 (9th Cir. 2006) ("*First Alliance*"); *see also* App. C at 35a ("[T]he Court finds that plaintiffs have satisfied the reliance element, on the basis of the Ninth Circuit's recent opinion in *First Alliance* and the district court opinion in *Lincoln Savings* that the Ninth Circuit endorsed."). Thus, following *First Alliance*, the trial court in this case found that "uniform" representations are sufficient to create a presumption of reliance. App. C at 37a. The trial court held: "First Command's misrepresentations were sufficiently similar to satisfy the commonality and typicality requirements of Rule 23(a), and to give rise to a presumption that plaintiffs relied on those misrepresentations . . . ." *Id.* at 36a.

The trial court in the instant case acknowledged that the presumption of reliance articulated in *Basic* was not available. *Id.* at 33a. However, following *First Alliance*, 471 F.3d at 992, the trial court held that the existence of "uniform" representations is

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[8] Like the Ninth Circuit, the Third Circuit's creation of a presumption of reliance based on uniform representations (in the absence of an efficient market) is closely tied to notions of "aiding and abetting" or scheme liability that were disavowed by this Court in *Central Bank*.

sufficient to create a presumption of reliance. App. C at 37a.

First Alliance was a fraud case and, although it did not involve Rule 10b-5, it was predicated in part on Rule 10b-5 authorities, citing *In re Am. Cont'l Corp./Lincoln Sav. & Loan Sec. Litig.*, 140 F.R.D. 425 (D. Ariz. 1992) ("*Lincoln Savings*"). The court in *Lincoln Savings* essentially used "scheme liability" as a substitute for proof of reliance in a Rule 10b-5 case. 140 F.R.D. at 433 (finding a presumption of reliance because the "alleged scheme to defraud is of such pervasive materiality"); *see also First Alliance*, 471 F.3d at 991-92. Thus, in *First Alliance*, the Ninth Circuit cited with approval the holding in *Lincoln Savings* that a class can be certified where the "center of gravity of the fraud transcends the specific details of oral communications." 471 F.3d at 991 (quoting *Lincoln Savings*, 140 F.R.D. at 430-31). To this extent, notions of "scheme liability" create the underpinning for the Ninth Circuit's presumption of reliance based on uniformity. The defendant in *First Alliance* argued that reliance was an individual issue. *Id.* at 992. Finding that "[t]he whole scheme was built on inducing borrowers to sign documents without really understanding the terms" (*id.*), the Ninth Circuit ruled: "We find unpersuasive in this case the defense that plaintiffs should not have relied on statements that were made with the fraudulent intent of inducing reliance." *Id.* This finding eliminated the reliance requirement by conflating it with the separate falsity and proximate cause elements of liability.[9]

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[9] The court in *First Alliance* also relied on California state law. 471 F.3d at 992.

First Alliance, the cases on which it is predicated, and the decision in the instant case, demonstrate a circuit split on whether "uniform" representations are sufficient to trigger a presumption of reliance (enabling class certification). App. C at 37a. Since "uniform" representations exist in essentially all securities cases (10K's, 10Q's, proxies and the like), the Third and Ninth Circuits may now (contrary to *Basic*) certify securities class actions where the case does not involve the price of stock traded on an "open . . . [and] well developed" securities market. Broker-dealer cases such as this case, involving face-to-face client meetings—traditionally resolved in NASD arbitrations (now called FINRA arbitrations)—may now be certified for class-wide adjudication in the Third and Ninth Circuits but not the First, Second, Fourth, Fifth, Sixth and Seventh Circuits. The Ninth Circuit has endorsed such class certification without meeting the "fraud-on-the-market" test of *Basic* (or the "omissions" test of *Affiliated Ute Citizens v. United States*, 406 U.S. 128, 153-54 (1972)).[10]

Moreover, as shown above, while the Ninth Circuit has eased the presumption of reliance and required only a showing of "uniform" representations, the Second and Fifth Circuits have moved in the opposite direction, tightening up the prerequisites for this presumption and widening the already mature split between the circuits on whether "uniform" representations can comprise an alternative to the *Basic* presumption of reliance. The securities laws are supposed to be uniform across the country, but there are now significant differences between the circuits

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[10] The trial court in the instant case found that the *Affiliated Ute* presumption is not available because the case is not primarily about omissions. App. C at 34a-35a.

on the important issue of when a class can be certified.[11]

A presumption of reliance based on uniformity alone also appears to conflict with this Court's decision in *Amchem Prods., Inc. v. Windsor*, 521 U.S. 591 (1997). In *Amchem*, the district court had certified a settlement class based on (i) the "shared experience" of class members in being exposed to asbestos (*i.e.*, commonality), and (ii) the common interest of class members in obtaining compensation. *Id.* at 623-24. Rejecting the use of commonality as a basis for finding predominance under Rule 23(b)(3), the Court held that the predominance requirement is "far more demanding" than simply showing a common experience or harm. *Id.* at 624. This strongly suggests that the Third and Ninth Circuits are wrong to permit a finding of predominance based solely on uniformity or commonality.

In short, the decision of the trial court and the denial of the Rule 23(f) Petition in this case, and the decision of the Ninth Circuit in *First Alliance,* have resulted in a class proceeding that (i) far departs from the accepted and usual course of judicial proceedings (SUP. CT. R. 10(a)) and (ii) exemplifies the mature circuit split that erupted after this Court's decision in *Basic*. Indeed, *First Alliance* is part of a line of Ninth Circuit cases that have eroded the reliance requirement based on an expansive view of scheme liability. *See, e.g., In re Software Toolworks*

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[11] The rulings of the Third and Ninth Circuits also contradict a core principle of Rule 23(b)(3). "[A] fraud case may be unsuited for treatment as a class action if there was material variation [1] in the representations made or [2] in the kinds or degrees of reliance by the persons to whom they were addressed." FED. R. CIV. P. 23(b)(3) advisory committee's note (1966 amendment).

Inc. Sec. Litig., 50 F.3d 615, 628 n.3 (9th Cir. 1994) (liability for playing a "significant role" in false statements without reference to reliance); *Arthur Young & Co. v. U.S. Dist. Ct.*, 549 F.2d 686, 695 (9th Cir. 1977) (establishing a presumption of reliance on the "regulatory process" and allowing class certification for a new securities issue even though all securities are regulated, thereby making the *Basic* presumption superfluous).

II. The Circuit Split on "Commonality."

Another integrally related conflict between the circuits also arose in this case. The Ninth Circuit openly acknowledged in *First Alliance* that there is a circuit split on the fundamental issue of how to judge commonality under Rule 23(a) in a class action. 471 F.3d at 990-91 & n.3 ("[S]ome other courts have adopted somewhat different standards in identifying the degree of factual commonality required . . . ."). For example, the Second and Third Circuits have "highlighted the importance of uniformity . . . in order to establish that element of fraud on a class-wide basis." *Id.* at 990 n.3 (citing *Moore v. PaineWebber, Inc.*, 306 F.3d 1247, 1255 (2d Cir. 2002) and *In re LifeUSA Holding Inc.*, 242 F.3d 136, 145-47 (3d Cir. 2001)). In contrast, the Ninth Circuit allows a finding of commonality based on a "common course of conduct . . . [that] is in its broad outlines actionable." *Id.* at 990 (quoting *Blackie v. Barrick*, 524 F.2d 891, 902 (9th Cir. 1975) (internal quotation marks omitted)).

Further, while some circuits adhere to this Court's "rigorous analysis" test (*Gen. Tel. Co. of Sw. v. Falcon*, 457 U.S. 147, 161 (1982) ("*Falcon*")), the Ninth Circuit uses a "liberal" and "permissive" standard

that defaults in favor of class certification. App. C at 22a-23a.[12] The Third Circuit has adopted a lenient standard for commonality determinations. *See Newton v. Merrill Lynch, Pierce, Fenner & Smith, Inc.*, 259 F.3d 154, 182-83 (3d Cir. 2001) ("We have set a low threshold for satisfying both [commonality and typicality] requirements."). In contrast, the Second Circuit recently "discarded" this "lenient" standard. *In re Initial Public Offerings Sec. Litig.*, 471 F.3d 24, 42 (2d Cir. 2006).

In the end, this Court has held that "actual, not presumed, conformance with Rule 23(a) remains . . . indispensable." *Falcon*, 457 U.S. at 160. The "liberal" Ninth Circuit test essentially presumes such conformance, which is inconsistent with this Court's rulings.[13]

This Court has not specifically addressed how to measure commonality or the degree of commonality required for class certification. As shown above, the circuits are split on this issue.

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[12] The Ninth Circuit's lenient standard essentially shifts the burden to defendants. *Cf. Szabo v. Bridgeport Machs., Inc.*, 249 F.3d 672, 676-77 (7th Cir. 2001) (rejecting, under *Falcon*, the district court's Rule 23 approach because "[c]ertifying classes on the basis of incontestable allegations in the complaint moves the court's discretion to plaintiff's attorneys-who may use it in ways injurious to . . . defendants").

[13] Indeed, despite the "rigorous analysis" standard imposed by this Court, the class certification order in this case piles one presumption on top of another. The district court found commonality based on a "permissive" standard, and then used that finding as the basis for a presumption of reliance.

III. The Rules Enabling Act, the Seventh Amendment, and the Due Process Clause.

Both of the circuit splits described above have significant ramifications under the Rules Enabling Act, the Seventh Amendment, and the Due Process Clause.

Under the Rules Enabling Act, a procedural rule "shall not abridge, enlarge or modify any substantive right." 28 U.S.C. § 2072(b); *Ortiz v. Fibreboard Corp.*, 527 U.S. 815, 845 (1999). The Rules Enabling Act is violated by the Ninth Circuit's class formulation because FED. R. CIV. P. 23(b)(3) is a procedural rule, while the reliance element of Rule 10b-5 is a substantive requirement of law. The Ninth Circuit has circumvented the substantive reliance requirement by adopting a presumption of reliance that is not realistically possible to rebut. Because this case does not involve the market price of a publicly traded security, the only realistic way to rebut the presumption of reliance would be evidence of what was actually said and relied on in one-on-one meetings with brokers. Such evidence from thousands of investors is not feasible in a class-wide trial.

The Seventh Amendment ramifications are also significant. U.S. CONST. amend. VII. Rule 10b-5 claims are governed by the Seventh Amendment. *See Tellabs, Inc. v. Makor Issues & Rights, Ltd.*, 127 S.Ct. 2499, 2512 (2007) (citing *Monroe Employees Ret. Sys. v. Bridgestone Corp.*, 399 F.3d 651, 683 n.25 (6th Cir. 2005) ("Traditionally, there has been a right to jury trial for securities fraud claims.")). By denying the

Rule 23(f) Petition in this case and allowing the class to proceed, the Ninth Circuit has abused the discretion afforded by Rule 23(f) in a way that violates the Seventh Amendment. The Ninth Circuit rule (which presumes reliance merely on the basis of "uniform" representations) eliminates the right to a jury trial as to absent class members. In meetings between First Command representatives and absent class members, the First Command representatives may have made different statements, may have responded to different questions, and may have clarified the alleged misrepresentations to remove any misleading taint. More importantly, an unknowable number of absent class members may not have relied on the alleged false statements, or may not have heard or understood those statements.[14] Significantly, in an individual case brought by a single investor, the entire case would revolve around what was actually said to that investor and what he or she relied on. Thus, in the class proceeding sanctioned by the Ninth Circuit, absent class members could win a judgment (or, they could be forever barred from recovery) based on evidence that is wholly unrelated to what they would introduce if they brought their own cases.

Because it would be impractical, in a class-wide trial, to introduce evidence about thousands of oral meetings, defendants will not have a realistic oppor-

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[14] For example, absent class members may have purchased the mutual funds not because of the alleged misrepresentations, but because they independently liked the underlying mutual funds; or because their First Command representative was highly respected (*cf.* App. C at 5a-6a ("affinity marketing")); or because their roommate said it was a good investment.

tunity to rebut the presumption of reliance.[15] Further, if the trial demonstrates that the class representatives' claims lack merit, then thousands of absent class members will be barred from relief by res judicata even though they may have relied on widely different considerations in making their investments.

This Court has not previously addressed the Seventh Amendment issues associated with Rule 23(b)(3), particularly in the narrow situation where a material element of the underlying claim is proven only with a presumption that cannot, in the real world, be meaningfully rebutted.

Finally, a class-wide jury verdict would also violate due process by taking property without affording First Command the right to defend itself against claims by absent class members. U.S. CONST. amend. V; *Oscar Private Equity Invs. v. Allegiance Telecom, Inc.*, 487 F.3d 261, 267 (5th Cir. 2007) ("That there are important due process concerns of both plaintiffs and defendants inherent in the certification decision, cannot be gainsaid.") (internal quotation marks and citation omitted).

In the end, uniformity is different from reliance. The Third and Ninth Circuits have conflated those concepts by allowing a finding of reliance based on uniformity, thereby eliminating the right to a jury trial on a material element of a claim. In a "fraud-on-the-market" case under *Basic*, the Seventh Amend-

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[15] In *Dura Pharms., Inc. v. Broudo*, 544 U.S. 336, 345 (2005), the Court quoted with approval from Justice White's concurrence in part and dissent in part in *Basic*: "[A]llowing recovery in the face of affirmative evidence of nonreliance—would effectively convert Rule 10b-5 into a scheme of investor's insurance." The same can be said for creating a presumption of reliance that cannot realistically be rebutted.

ment may not be violated by the judicially-created presumption of reliance because all class members presumptively rely on the stock price in making their investment. In such a case, the defendant may attempt to rebut this presumption, for example, with evidence that corrective information entered the market. But in a case such as the instant case—not involving the market price of a security—the presumption of reliance interferes with legitimate jury trial rights. As shown above, the only plausible way to rebut the presumption of reliance would be on an individual basis. A class-wide jury trial in this case means no jury trial at all for the defendants and the absent class members.

Until the enactment of FED. R. CIV. P. 23(b)(3), class-wide damages were generally not permitted. In *Amchem*, Justice Ginsberg, speaking for the Court, noted that Rule 23(b)(3) had been considered "the most adventuresome" of the new class action rules when adopted in 1966. 521 U.S. at 614. The Court also recognized in *Amchem* that the class procedure is subject to the Rules Enabling Act. *Id.* at 613. Based on *Amchem*, a class procedure should not be disconnected from the material elements of the underlying cause of action. Reliance is an important element of a claim under Rule 10b-5, and that element has been significantly eroded by the growing circuit split described above.[16]

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[16] There has been debate about whether Rule 23(b)(3) achieves much in the securities context, other than transferring vast wealth to plaintiffs' attorneys. *See, e.g.*, Kara Scannell, *SEC to Study Revamp on Shareholder Suits*, THE WALL STREET JOURNAL, Sep. 24, 2007, at C2. In contrast, the robust NASD (now FINRA) arbitration system has yielded consistent results in resolving legitimate broker/shareholder disputes for decades.

See http://www.finra.org/ArbitrationMediation/index.htm.

IV. The Circuit Split on the Standard for Granting a Petition under Rule 23(f).

Finally, this case also exemplifies the split between the circuits on the proper standard for granting Rule 23(f) petitions.[17]

The Fourth Circuit has adopted a flexible sliding-scale approach to the consideration of Rule 23(f) petitions. *Lienhart v. Dryvit Sys., Inc.*, 255 F.3d 138, 145-46 (4th Cir. 2001). The Eleventh Circuit considers the nature and status of the litigation and the likelihood that future events will make immediate appellate review more appropriate (in addition to other factors). *Prado-Steiman ex rel. Prado v. Bush*, 221 F.3d 1266, 1276 (11th Cir. 2000). The Seventh Circuit considers the impact of class certification in turning a small dispute into a "bet-your-company" case that generally must be settled, thereby evading appellate review. *Szabo v. Bridgeport Machs., Inc.*, 249 F.3d 672, 675 (7th Cir. 2001). The Ninth Circuit considers a different mix of factors, some overlapping with those in other circuits. *Chamberlan v. Ford Motor Co.*, 402 F.3d 952, 958-60 (9th Cir. 2005).

Petitioners contend that where, as here, a class certification decision disregards Supreme Court authority, constitutes manifest error, violates the Seventh Amendment, and threatens a death knell for the defendant or the case (thereby making post-judgment review unlikely), the denial of a remedy under Rule 23(f) can raise significant constitutional issues

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[17] To consider the circuit splits on reliance and commonality raised in this Petition, the Court does not need to address the standard for granting Petitions under Rule 23(f). Rather, the Court could review the substance of the underlying circuit splits as an exercise of its supervisory powers under SUP. CT. RULE 10(a).

justifying review. These factors should be part of the mix.

* * *

Because this case involves the denial without opinion of a discretionary Petition for interlocutory review, the case is not in the procedural posture that the Court might prefer when considering certiorari. However, the extraordinary *in terrorem* impact of class-wide damages makes it unlikely that the important securities litigation issues raised in this case will ever be presented on a fully developed record. Further, decisions that terminate cases (resulting in a judgment adverse to the plaintiffs) can be reviewed, while decisions that improperly sustain cases usually cannot, giving plaintiffs' attorneys an extraordinary ability to control the appellate docket. Nevertheless, securities litigation has a tremendous impact on the national and international economy. As a result, this Court's certiorari power is often invoked in securities cases that are in a less complete procedural posture than other kinds of cases. The circuit splits raised by this Petition are no less compelling merely because of the procedural posture.

CONCLUSION

The petition for writ of certiorari should be granted.

Respectfully submitted,

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November 9, 2007

APPENDIX

APPENDIX A

UNITED STATES COURT OF APPEALS
FOR THE NINTH CIRCUIT

[Filed NOV. 1, 2007]

No. 07-80123
D.C. No. CV-05-00179-IEG
Southern District of California, San Diego

FIRST COMMAND FINANCIAL PLANNING, INC.; *et al.*,
Defendants - Appellants,

v.

MICHAEL MCPHAIL; *et al.*,
Plaintiffs - Appellees.

ORDER

Before: PREGERSON and THOMAS, *Circuit Judges.*

Appellants' "petition for rehearing en banc on denial of permission to appeal from order granting class certification" is construed as a motion for reconsideration en banc. The motion for reconsideration en banc is denied on behalf of the court. *See* 9th Cir. Gen. Ord. 6.11; *see also* Fed. R. Civ. P. 23(f); *Chamberlan v. Ford Motor Co.*, 402 F.3d 952 (9th Cir. 2005) (per curiam).

No motions for reconsideration, rehearing, clarification, or any other submissions shall be filed or entertained in this closed docket.

DENIED.

APPENDIX B

UNITED STATES COURT OF APPEALS
FOR THE NINTH CIRCUIT

[Filed SEP. 14, 2007]

No. 07-80123
D.C. No. CV-05-00179-IEG
Southern District of California, San Diego

FIRST COMMAND FINANCIAL PLANNING, INC.; *et al.*,
Defendants - Appellants,

v.

MICHAEL MCPHAIL; *et al.*,
Plaintiffs - Appellees.

ORDER

Before: PREGERSON and THOMAS, *Circuit Judges.*

The Clerk shall file appellees' answer to the petition for permission to appeal the district court's July 30, 2007 order granting class certification, received August 23, 2007.

Appellants' motion for leave to file a reply in support of the petition is granted.

The court, in its discretion, denies the petition for permission to appeal the district court's order granting class action certification. *See* Fed. R. Civ. P. 23(f); *Chamberlan v. Ford Motor Co.*, 402 F.3d 952 (9th Cir. 2005) (per curiam).

DENIED.

APPENDIX C

UNITED STATES DISTRICT COURT
SOUTHERN DISTRICT OF CALIFORNIA

[Filed July 30, 2007]

CASE NO. 05CV179 IEG (JMA)
(Doc. Nos. 148, 164)

MICHAEL MCPHAIL; ROBERT BARR KIMNACH III; KEVIN and JENNIFER MORRISON; SCOTT and KRYSTIN WAGNER; CANDACE and NEIL HURLEY; on behalf of themselves and all others similarly situated,

Plaintiffs,

vs.

FIRST COMMAND FINANCIAL PLANNING, INC.; FIRST COMMAND FINANCIAL SERVICES, INC.; LAMAR C. SMITH; and HOWARD M. CRUMP,

Defendants.

ORDER (1) GRANTING IN PART PLAINTIFFS' MOTION FOR CLASS CERTIFICATION, (2) GRANTING IN PART, DENYING IN PART DEFENDANTS' MOTION TO STRIKE THE BULLARD REPORT, and (3) DENYING ALL DEFENDANTS' REMAINING MOTIONS TO STRIKE

Presently before the Court is plaintiffs' motion for class certification. (Doc. No. 148.) Also presently before the Court are defendants' motions to strike (1) the Bullard Report, (2) references in the consolidated second amended complaint ("CSAC") to a January 2000 letter from the National Association of Securities Dealers ("NASD"), (3) class allegations against First Command Financial Services, Inc. ("the

parent corporation") and Smith and Crump (taken together, "individual defendants"), and (4) portions of the proposed class definition. (Doc. No. 164.) For the reasons stated below, the Court grants the motion for class certification but modifies the definition of the class. The Court grants in part the motion to strike the Bullard Report. The Court denies the other motions to strike.

BACKGROUND

A. Factual History

First Command Financial Planning, Inc. ("First Command") has over 297,000 customers in the United States military, including 40% of the current active-duty general officers, one third of the commissioned officers, and 16% of the non-commissioned officers. (Pls. Memo. ISO Motion for Class Certification, at 4; CSAC ¶ 7.) Of the approximately $10.1 billion that First Command customers invested in mutual funds since 1970, about 70% of that business consisted of the sale of systematic investment plans ("SIPs") (CSAC ¶ 20.) First Command sold five different SIPs, and each plan then made a purchase from one of five different mutual funds. (*Id.*) Prior to the events giving rise to this litigation, First Command was the "dominant retailer" of SIPs. (H.R. Rep. No. 109-40, at 5 (2005)). Of the more than seven trillion dollars invested in the entire mutual fund market, SIPs accounted for only eleven billion dollars, 90% of which was held by military personnel. (*Id.*)

As explained by the Securities and Exchange Commission ("SEC"), in a First Command SIP:

> the investor is to pay 180 fixed monthly installments (15 years), which may be extended to 300 payments (25 years) at the investor's option with

> no additional sales charge. First Command customers pay a front-end sales load equal to 50% of the first 12 payments, but thereafter pay no additional front-end sales load for the life of the plan.

(Pls. Notice of Lodgment ("NOL"), Exhibit 2 ¶ 5.) For example, if a First Command customer paid $100 per month for the first twelve investments (total contribution of $1,200); only $600 was actually invested in the purchase of mutual fund shares.[1] The other $600 was a sales charge, 92.4% of which was paid to First Command. (NOL, Exhibit 3, at 6.) Furthermore, if a First Command customer later increased the investment amount, the 50% sales charge would apply for one year to the increased amount. (NOL, Exhibit 4, at 57, & Exhibit 36, at 180-81.)

After an investor made the first twelve payments, the effective sales load decreased with each payment. The sales load was 3.3% if the investor made all 180 payments, and eventually decreased to 2% if the investor makes 300 payments. (NOL, Exhibit 2 ¶ 6.) If the investor stopped making payments along the way, however, the effective sales load would be higher. Potentially, the load would exceed the 8.5% maximum allowable front-end load commission for conventional load funds[2] and/or the 5.75% industry standard for sales loads. (Bullard Decla., Exhibit 1 ¶ 10.)

To sell SIPs, First Command relied on the "affinity marketing" strategy. A majority of First Command's sales representatives are former military profession-

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[1] First Command also offered a no-load fund, the Select Investor Program, for customers investing a minimum of $250,000. (NOL, Exhibit 22, at 017274.)

[2] *See* NASD Rule 2830(d).

als. (NOL, Exhibit 19.) Based on the similarity of backgrounds, these representatives engendered the trust of potential First Command customers. (*See, e.g.*, McPhail Depo., at 40:22–41:1.) Affinity marketing was particularly effective in the military context because of officers' training to rely on the honesty and integrity of fellow officers. (Consolidated SAC ¶ 7.)

Furthermore, First Command trained its sales force to deliver a "homogenized" presentation that gave prospective SIP customers the "same story," regardless of the agent. (NOL, Exhibit 26.) Specifically, First Command directed its sales representatives to memorize the "track," *i.e.*, a script of a conversation with a hypothetical military couple. (NOL, Exhibit 28, at 041967, & Exhibit 30, at 29:14–30:3.) For example, John Ball, the agent who sold a SIP to plaintiff Michael McPhail, had to memorize "[n]early a hundred percent" of the track before First Command allowed Ball to make sales presentations to potential customers. (NOL, Exhibit 31, at 77:9.) Because the sales representatives memorized the tracks so well, customers such as plaintiff Robert Kimnach received "the exact same responses" to questions they posed to sales representatives in different cities. (NOL, Exhibit 33, at 115:11-17.) According to First Command's then-CEO, however, sales representatives were "[a]bsolutely not" required to adhere verbatim to the track during a sales meeting because "[i]t would be impractical to do so." (Kelley Decla., Exhibit J, at 413:18-19.)

First Command's "track," together with the accompanying charts and graphs, contained misleading

statements and omissions[3] that triggered SEC cease-and-desist proceedings and a NASD investigation into alleged rule violations.[4] (NOL, Exhibits 2-3.) For example, First Command represented the 50% front-end sales load would discipline investors to stay committed to the SIP by making at least 180 payments. (NOL, Exhibit 2 ¶ 25, & Exhibit 3, at 8-9.) However, this statement was inaccurate in light of data that only 43% of First Command customers purchasing between 1980 and 1987 actually completed their SIPs by 2004.[5] (*Id.*) Furthermore, among the remaining plans, some plans were "dormant" because customers had not contributed for an entire year. (Bullard Decla., Exhibit 1 ¶ 20.) First Command also failed to inform investors about the earnings they lost by paying such high front-end sales loads. (NOL, Exhibit 2 ¶ 20, & Exhibit 3, at 9.) Because the sales charges were not invested from the beginning, SIP holders did not make as much money over time. (*Id.*)

First Command sales personnel further misrepresented the nature of investment alternatives. They claimed that no-load mutual funds were popular among speculators and that load funds were typically restricted to large, private accounts. (NOL, Exhibit 2 ¶¶ 19, 21, & Exhibit 3, at 9-10.) They claimed that no-load funds had some of the highest-long term costs

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[3] The Court provides a representative sample of the misstatements and omissions identified by the SEC and NASD here, but does not endeavor to catalog all such alleged misrepresentations.

[4] Respondent's sanctions included a $12 million fine for restitution and investor education. (NOL, Exhibit 2 ¶ 29(a), & Exhibit 3, at 18.)

[5] The rate at which customers remained in or exited their SIPs is called the "persistency rate."

when, in fact, no-load funds have substantially lower costs. (NOL, Exhibit 2 ¶ 21, & Exhibit 3, at 10.) Some load funds allow contributions as small as $50/month. (*Id.*) Despite representing that no-load funds were for speculators, defendants failed to inform customers of the Thrift Savings Plan ("TSP"), a federal government retirement savings plan offering investments in five no-load funds. (NOL, Exhibit 3, at 4 & n.6.)

First Command further exaggerated the extent to which customers could obtain the benefits of "dollar cost averaging"[6] only through a SIP. No-load and load mutual funds often have effective dollar-cost-averaging features. (NOL, Exhibit 2 ¶ 19, & Exhibit 3, at 10.) Furthermore, the mere reliance on dollar cost averaging did not mean SIPs would perform better than more conventional mutual funds.

Finally, First Command used misleading sales charts that overstated the cash volatility of investments other than SIPs ("Stable Cash Flow Chart"). (NOL, Exhibit 2 ¶ 22, & Exhibit 3, at 11-12.) Another sales chart misrepresented the average time that an investor remained in a SIP versus other types of investments ("Holding Period Chart"). (NOL, Exhibit 2 ¶ 22, & Exhibit 3, at 12-13.) As the source of data, both charts cited data from the Investment Company Institute ("ICI"), but ICI produced no data on cash volatility and specifically warned against using its information to calculate holding periods. (NOL, Exhibit 2 ¶ 23, & Exhibit 3, at 11-13.)

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[6] As defined by the NASD, "[d]ollar cost averaging is the process of investing a fixed amount on a periodic basis so that the investor purchases shares at different prices." (NOL, Exhibit 3, at 10.) Specifically, by investing the same amount each period, the investor purchases more shares when the security price is low, and fewer shares when the price is high.

On September 29, 2006, President Bush signed into law the Military Personnel Financial Services Protection Act, which banned SIP sales. Pub. L. 109-290, § 4, 120 Stat. 1317, 1318-19 (2006) (codified at 15 U.S.C. § 80a-27(j)). There, Congress found the SIP "largely disappeared from the civilian market in the 1980s, due to excessive sales charges[.]" *Id.* § 2(4). Congress condemned "excessive sales charges [that] allow abusive and misleading sales practices in connection with [SIPs]." *Id.* § 2(6).

B. Procedural History

After filing a complaint and first amended complaint (Doc. Nos. 1, 29), plaintiffs then filed a consolidated amended complaint ("CAC") on July 22, 2005 (Doc. No. 70). On April 10, 2006, the Court granted in part defendants' motion to dismiss the CAC. (Doc. No. 108.) The Court dismissed without prejudice plaintiffs' claim under § 10(b) of the Securities Exchange Act of 1934 and Rule 10b-5 because plaintiffs failed to adequately plead scienter. (*Id.* at 9.) The Court dismissed plaintiffs' claim under the Investment Advisers Act ("IAA") for lack of standing. (*Id.* at 11.) The Court denied defendants' motion to dismiss plaintiffs' claim under § 12(a)(2) of the Securities Act of 1933. (*Id.* at 12.)

Plaintiffs filed the CSAC on May 1, 2006. (Doc. No. 110.) The CSAC abandoned the IAA claim and presented only two claims: a § 10(b)/Rule 10b-5 claim and a § 12(a)(2) claim. On July 27, 2006, after defendants moved to dismiss the CSAC, the Court denied that motion with respect to the § 10(b)/Rule 10b-5 claim but dismissed the § 12(a)(2) claim with prejudice. (Doc. No. 121.) Therefore, plaintiffs have a lone § 10(b)/Rule 10b-5 claim remaining.

On February 27, 2007, the Court set an extended briefing schedule on plaintiffs' motion for class certification. (Doc. No. 144.) On April 30, 2007, plaintiffs filed the motion. (Doc. No. 148.) On May 25, 2007, defendants filed their opposition (Doc. No. 156) and their motions to strike (Doc. No. 157.) On June 11, 2007, plaintiffs filed their opposition to the motions to strike. (Doc. No. 166.) On June 18, 2007, the parties filed their respective replies. (Doc. Nos. 168-69.) The Court held oral argument on June 25, 2007 and then took the matter under submission.

DISCUSSION

A. Defendants' Motions To Strike

1. Legal Standard

Pursuant to Federal Rule of Civil Procedure 12(f):

> Upon motion made by a party before responding to a pleading or, if no responsive pleading is permitted by these rules, upon motion made by a party within 20 days after the service of the pleading upon the party or upon the court's own initiative at any time, the court may order stricken from any pleading any insufficient defense or any redundant, immaterial, impertinent, or scandalous matter.

"A motion to strike should not be granted unless the matter to be stricken clearly could have no possible bearing of the subject of the litigation. If there is any doubt whether the portion to be stricken might bear on an issue in the litigation, the court should deny the motion." *Platte Anchor Bolt, Inc. v. IHI, Inc.*, 352 F. Supp. 2d 1048, 1057 (N.D. Cal. 2004) (internal citations omitted). The court views the pleading in the light most favorable to the nonmoving party. *In re*

2TheMart.com, Inc. Sec. Litig., 114 F. Supp. 2d 955, 965 (C.D. Cal. 2000).

2. Bullard Report[7]

Defendants filed their motion to strike more than twenty days after plaintiffs served their motion for class certification. Although defendants' motion is, therefore, technically untimely under Rule 12(f), defendants filed the motion along with their timely opposition to the plaintiffs' motion for class certification. Furthermore, the Court adopted an extended briefing schedule for this motion. Therefore, the Court reaches the merits of defendants' motion to strike the Bullard Report.

In support of their motion for class certification, plaintiffs submitted the expert report of Mercer Bullard, an assistant professor at the University of Mississippi School of Law. (Bullard Decla. ¶¶ 2, 4.) Bullard teaches courses in corporate and securities law. (Bullard Decla., Exhibit 2.) Prior to entering academia, Bullard was employed at the SEC's Division of Investment Management, where he last held the position of assistant chief counsel. (*Id.*)

At the class certification stage, courts employ "'a lower *Daubert* standard'" to analyze the admissibility of expert testimony. *Dukes v. Wal-Mart, Inc.*, 474 F.3d 1214, 1227 (9th Cir. 2007) (quoting *Thomas &*

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[7] Defendants' motion to strike the Bullard Report has limited import. First, as plaintiffs conceded at oral argument, the Court can certify the class without the Report, *i.e.*, by relying on the same pleadings, deposition transcripts, and evidence that Bullard cites. Second, to the extent defendants maintain that Bullard cannot satisfy a *Daubert* standard, they may renew their motion at a subsequent stage of the litigation. *Foster v. St. Jude Med., Inc.*, 229 F.R.D. 599, 600 n.1 (D. Minn. 2005).

Thomas Rodmakers, Inc. v. Newport Adhesives & Composites, Inc., 209 F.R.D. 159, 162 (C.D. Cal. 2002)). Although this standard is "more lenient," the Court "'must ensure that the basis of the expert opinion is not so flawed that it would be inadmissible as a matter of law.'" *Sepulveda v. Wal-Mart Stores, Inc.*, 237 F.R.D. 229, 235 (C.D. Cal. 2006) (quoting *In re Visa Check/MasterMoney Antitrust Litig.*, 280 F.3d 124, 135 (2d Cir. 2001)). Where an "expert report" amounts to "written advocacy . . . akin to a supplemental brief," a motion to strike is appropriate because this evidence is not useful in evaluating whether class certification requirements have been met. *Fisher v. Ciba Specialty Chems. Corp.*, 238 F.R.D. 273, 281 (S.D. Ala. 2006).

Defendants claim a litany of grounds for striking the Bullard Report. The most persuasive is that Bullard used purely hypothetical assumptions in his calculations of the persistency rate. The report contains a number of speculative calculations about the percentage of accounts that were cancelled (¶¶ 17-19), dormant (¶¶ 21-23), and inactive (¶¶ 25-26.) Because Bullard lacks any basis for the assumptions underlying his calculations, the Court strikes these eight paragraphs.[8]

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[8] The fact that First Command underestimated the number of terminated accounts and did not account for dormant or inactive accounts does assist the Court in determining whether plaintiffs have satisfied the requirements of class certification. The existence of dormant and inactive accounts is relevant to the issue of whether the class should include plaintiffs who have not yet terminated their SIPs. If certain First Command investors have passively stopped investing or reduced the frequency of their investment, their effective sales load will never fall below the legal maximum. First Command's failure to disclose this data about dormant and inactive accounts also counts as another

The Court finds it appropriate to strike other potions of the report. In paragraph 34, Bullard begins by discussing the misrepresentation that the 50% front-end load keeps out speculators. However, after the citation to footnote 24, Bullard then asserts that First Command's clients may have themselves engaged in speculation. Bullard cites no evidence for this assertion, and, therefore, the Court strikes paragraph 34 after the citation to footnote 24.

Finally, the first sentence of paragraph 66 states that First Command violated laws not at issue in this case. The Court strikes that irrelevant sentence.

While the Bullard Report occasionally rehashes deposition testimony and summarizes various exhibits, the Court declines to parse the report line-by-line to strike every instance in which Bullard merely restates the record. The Court finds that Bullard reliably applied his expertise as a securities law scholar and a former SEC attorney to create a useful description of the misrepresentations in First Command's script and the training program that emphasized adherence to the script when selling SIPs. For example, paragraphs 38-39 explain how the 50% load was excessive not only in the amount charged, but also in its subsequent effect on investment performance. Specifically, Bullard shows the difference in returns from investing in a SIP versus a load fund. This information is relevant in the determination of whether class

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omission common to the entire class. The existence of a greater number of common issues makes it more likely that those issues will predominate over individual ones. The problem with the Bullard Report is that, after identifying the existence of such dormant or inactive accounts, Bullard then speculates about how many accounts are actually dormant or inactive.

members who have not terminated their SIPs suffered economic loss.

Also, paragraphs 55-57 discuss a misrepresentation not meaningfully discussed in the SEC and NASD letters: whereas First Command represented to customers that its research and planning staff independently developed a unique financial plan, the staff essentially rubber-stamped the recommendation of First Command's sales advisor. Every misrepresentation provides another common issue appropriate for class adjudication.

3. January 2000 Letter

The CSAC repeatedly references a letter that NASD mailed in January 2000 warning defendants of alleged false statements in their advertising material. (Doc. No. 110, at 3, 14, 17, 20, 22, 26, 28, 30, 33, 68, 70, 74, 76, 79, 81, 84, & 86.[9]) The Court relied on this letter when it denied defendants' motion to dismiss the CSAC's Rule 10b-5 claim, finding that the letter enabled the plaintiffs to plead scienter adequately. Even then, defendants insisted that such a letter did not exist. The Court stated, "if it later becomes clear that plaintiffs did not have a good faith

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[9] The following is a representative example of such a reference:

> Specifically, the NASD has confirmed that prior to January 2000 the NASD Advertising Regulation Department reviewed the First Command sales script and that, as a result of this review, the NASD in January 2000 sent a letter to First Command's Chief Compliance Officer (Howard Crump) with a copy to Lamar Smith. This letter summarized the NASD's concerns regarding the enumerated misleading statements and material omissions in the script which were later detailed in the NASD Order.

(Doc. No. 110, at 14.)

basis for pleading the existence of the NASD letters, the Court will take appropriate action." (Doc. No. 121, at 7 n.6.)

Plaintiffs now concede the January 2000 letter does not exist. (Pls. Opp. to Strike, at 11.) However, plaintiffs point to four letters NASD sent to First Command in 1999. (NOL, Exhibits 25, 40, & 49-50.) At least two of these letters (dated April 6 and June 1) address violations of NASD rules in First Command's "Predictable Cash Flow" chart. (*Id.*, Exhibits 25 & 49.) Defendants assert these letters are irrelevant because First Command never showed this chart to plaintiffs, but this argument elevates form over substance. NASD objected to the same kinds of misrepresentations allegedly made in this case (*e.g.*, that no-load funds have high cash volatility and attract speculators). Therefore, the Court's finding in its Order on the motion to dismiss the CSAC remains sound: taking the plaintiffs' allegations as true, First Command knew about the falsity of its representations prior to the class period. Furthermore, given the undisputed existence of the 1999 letters, the Court finds plaintiffs had a good-faith basis for referencing NASD correspondence in the CSAC.

Plaintiffs plausibly state that the SAC contains a "scrivener's error" when it says, "the NASD in January 2000 sent a letter". (Pls. Opp. to Strike, at 16.) Instead, that language should read "the NASD by January 2000 sent a series of letters." Finding that justice so requires, the Court grants plaintiff's request for leave to amend the CSAC to correct the scrivener's error.[10] *See* Fed. R. Civ. P. 15(a).

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[10] The Court further grants plaintiffs leave to amend the CSAC references to this series of letters, if plaintiffs wish to

4. Class Allegations

More than a year after plaintiffs filed the CSAC, defendants now move to strike the class allegations with respect to the parent company and the individual defendants. Seeking to avoid Rule 12(f), defendants claim their motion is responsive to plaintiffs' motion for class certification, which argues that plaintiffs satisfy the Rule 23 requirements only with respect to First Command. (Defs. Memo. ISO Strike, at 14-16.) Nonetheless, to the extent defendants argue the class cannot establish liability of the parent company and the individual defendants as a matter of law, the Court finds the motion to strike these class allegations untimely. Furthermore, even if the motion for class certification somehow makes defendants' motion to strike timely, the Court denies the motion to strike on the merits for the reasons stated below.[11]

a. Parent Company

Defendants assert, as a matter of law, that the parent company cannot be held liable for the securities fraud of its subsidiary, First Command. (Defs.

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amend the names of the recipients of those letters. The CSAC claims the letters were mailed to Howard Crump with a copy to Lamar Smith. However, of the NASD letters from 1999 that plaintiffs identify in their opposition, only one was mailed to Crump. (NOL, Exhibit 40.) Although captioned as a "Letter of Caution," this letter mentions none of the misrepresentations at issue in the case. The letters mentioning the specific misrepresentations at issue here were instead mailed to Gerald Stanley, First Command's Assistant Director of Public Relations. (NOL, Exhibits 25 & 49.)

[11] Denying the motions to strike is also inappropriate because the class allegations "might bear on an issue in the litigation." *Platte Anchor Bolt, Inc.*, 352 F. Supp. 2d at 1057.

Memo. ISO Strike, at 15.) Defendants further emphasize plaintiffs' failure to allege any grounds for piercing the corporate veil. (*Id.*) However, if defendants believe plaintiffs' claims against the parent company cannot prevail as a matter of law, they should have said so in their motion to dismiss the CSAC. Instead, defendants' Rule 12(b)(6) motion broadly sought to dismiss plaintiffs' claims with respect to all defendants. Rather than argue the parent company was entirely immune from securities fraud liability, plaintiffs instead argued that the CSAC failed to satisfy certain elements of a 10b-5 cause of action with respect to the corporate defendants. (Doc. No. 112, at 6-19.) Federal Rule of Civil Procedure 12(h)(2) provides other mechanisms for raising a defense for failure to state a claim outside of the 12(b)(6) motion, but a Rule 12(f) motion to strike is not one of them.

Furthermore, the Court denies the motion because discovery on this issue is incomplete. Plaintiffs make clear they intend to show the parent company is liable to the class by establishing an agency relationship between it and First Command. (Pls. Opp. to Strike, at 19-20.) The CSAC put defendants on notice by identifying the parent company as the "parent corporation" or "corporate parent" of First Command. (CSAC ¶¶ 4(b)(ii), 32.) So far, the parties have only exchanged documents relevant to this motion for class certification. (Nordrehaug Decla. ¶ 3(C).) Documents relevant to the relationship between First Command and the parent company will be exchanged after the Court decides the present motion for class certification. (*Id.*) After the completion of discovery, a motion for summary judgment may be the appropriate mechanism for adjudicating whether the parent company can be found liable, as a matter of law.

b. Individual Defendants (Smith and Crump)

Defendants submit three reasons for striking the class allegations as to the Smith and Crump. First, defendants claim the Court would have granted the motion to dismiss all the CSAC's claims as to Smith and Crump "if plaintiffs had not relied on the non-existent January letter." (Defs. Memo. ISO Strike, at 15.) As discussed above, although the correspondence was dated before January 2000, it does exist.[12]

Second, defendants rely on Smith's and Crump's deposition testimony that First Command representatives did not have to use the track verbatim in SIP sales meetings. (*Id.* at 16.) As explained in the discussion of plaintiffs' class certification motion *infra*, Ninth Circuit precedent does not require identical oral misrepresentations to all class members.

Finally, the individual defendants did not make misrepresentations to any plaintiff because they met with no investors during the class period. (*Id.* at 15.) Plaintiffs do not contest this factual point, but explain that they intend to proceed against Smith and Crump as "controlling persons" pursuant to Securities Exchange Act of 1934, § 20(a) (15 U.S.C. § 78t(a)). Defendants respond that the CSAC lacks a separate § 20(a) claim. (Defs. Reply ISO Strike, at 10 n.8.) The CSAC does, however, describe the individual defendants as "senior controlling officers." (CSAC, at 15:25-26.) The Court declines to strike the class allegations as to the individual defendants merely

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[12] Further, in opposition to the motion to strike, plaintiffs submit documentary evidence that at least one of the individual defendants (Crump) was internally notified of NASD's April 6, 1999 letter concerning misrepresentations in First Command's sales charts. (Nordrehaug Decla., Exhibit 4.)

because the CSAC lacks a separate cause of action for controlling-person liability. *See Paracor Fin., Inc. v. Gen. Elec. Capital Corp.*, 96 F.3d 1151, 1161-64 (9th Cir. 1996) (analyzing questions of controlling-person liability for Rule 10b-5 violations where plaintiff did not plead a separate cause of action under § 20(a)). If defendants believed the CSAC's stand-alone Rule 10b-5 cause of action was insufficient to establish liability against the individual defendants, they could have so argued in the motion to dismiss. The Federal Rules of Civil Procedure provide other mechanisms for defendants to litigate these issues on the merits later in the litigation.

5. Class Definition

Although plaintiffs' class definition originally appeared in the CSAC filed over a year ago, the Court considers defendants' motion to strike on the merits because the motion accompanied defendants' timely opposition to the motion for class certification, wherein plaintiffs changed its definition of the class. In the CSAC, plaintiffs defined the class as "all persons who, [from January 31, 2000 to December 31, 2004] purchased a SIP from First Command, or one of its predecessors in interest or made a SIP payment or increased their monthly SIP payments, and still owned their SIP as of December 15, 2004." (CSAC ¶ 81.) In the motion for class certification, however, plaintiffs defined the class as "all persons who, [from January 31, 2000 to December 31, 2004] made a SIP payment so as to be charged a 50% sales charge on the money placed at that time into the SIP through First Command and still owned the SIP on December 15, 2004." (Pls. Memo. ISO Class Certification, at 1-2.) At oral argument, plaintiffs' counsel stated that

plaintiffs wish to proceed with the class definition proposed in their motion for class certification.

In their motion to strike, defendants argue the revised class definition is overly broad because it includes customers who purchased their SIP before the class period and customers who have not terminated their SIPs. The Court addresses (and rejects) these arguments infra in the analysis of plaintiffs' motion for class certification. Therefore, the Court denies the motion to strike. However, because the Court modifies the class definition proposed in plaintiffs' motion for class certification, and because that proposed definition is likewise different from the class defined in the CSAC, the Court grants plaintiffs leave to amend the CSAC to conform the class definition according to this Order.

B. Plaintiffs' Motion for Class Certification

1. Legal Standard

Under Federal Rule of Civil Procedure 23(a), the prerequisites to a class action are:

> (1) the class is so numerous that joinder of all members is impracticable, (2) there are questions of law or fact common to the class, (3) the claims or defenses of the representative parties are typical of the claims or defenses of the class, and (4) the representative parties will fairly and adequately protect the interest of the class.

In addition to these prerequisites, plaintiffs must show at least one of the Rule 23(b) requirements is satisfied. Here, plaintiffs claim class certification is appropriate because "the questions of law or fact common to the members of the class predominate over any questions affecting only individual mem-

bers, and [because] a class action is superior to other available methods for the fair and efficient adjudication of the controversy." *Id.* 23(b)(3).[13]

In determining whether Rule 23 is satisfied, the Court must accept the truth of the allegations in the plaintiff's complaint. *Blackie v. Barrack*, 524 F.2d 891, 901 n.17 (9th Cir. 1975); *Westways World Travel, Inc. v. AMR Corp.*, 218 F.R.D. 223, 230 (C.D. Cal. 2003). As the party seeking to certify a class, plaintiffs bear the burden of demonstrating that they satisfy the elements of Rule 23. *Doninger v. Pac. Nw. Bell, Inc.*, 564 F.2d 1304, 1308 (9th Cir. 1977); *W. States Wholesale, Inc. v. Synthetic Indus., Inc.*, 206 F.R.D. 271, 274 (C.D. Cal. 2002).

2. Numerosity

Defendants do not rebut plaintiffs' estimate that the class consists of about 100,000 people. (Pls. Memo. ISO Class Certification, at 18.) This number is sufficient to make joinder impracticable. *See Lowdermilk v. U.S. Bank Nat'l Ass'n*, 479 F.3d 994, 997 (9th Cir. 2007) (finding numerosity satisfied where there were potentially thousands of eligible class mem-

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[13] Plaintiffs also claim the prosecution of separate actions would "create a risk of . . . (B) adjudications with respect to individual members of the class which would as a practical be dispositive of the interests of the other members not parties to the adjudications or substantially impair or impede their ability to protect their interests[.]" Fed. R. Civ. P. 23(b)(1)(B). Plaintiffs make a conclusory allegation that piecemeal litigation of their claims "would create the risk of inconsistent judgments" (Pls. Memo. ISO Class Certification, at 22). By asserting that the complexity of the claims and relatively small amount of any particular plaintiff's damages would prevent piecemeal litigation, however, plaintiffs are really arguing that a class action is the superior method of adjudication.

bers). The Court finds this action satisfies the numerosity requirement.

3. Commonality

Common questions of law and fact exist where "the complaint alleges a common course of conduct over the entire period, directed against all investors, generally relied upon, and violating common statutory provisions[.]" *Harris v. Palm Springs Alpine Estates, Inc.*, 329 F.2d 909, 914 (9th Cir. 1964) (interpreting an earlier but similarly worded version of Rule 23). The Ninth Circuit applies a "common course of conduct" test to determine whether to certify a class in a fraud case. *Blackie*, 524 F.2d at 903-04; *In re Badger Mountain Irrigation Dist. Sec. Litig.*, 143 F.R.D. 693, 698 (W.D. Wash. 1992). Therefore, class certification is appropriate where investors are "allegedly defrauded over a period of time by similar misrepresentations[.]" *Blackie*, 524 F.2d at 902; *accord In re Prudential Ins. Co. Am. Sales Practice Litig. Agent Actions*, 148 F.3d 283, 314 (3d Cir. 1998); *Negrete v. Allianz Life Ins. Co. of N. Am.*, 238 F.R.D. 482, 492 (C.D. Cal. 2006). The existence of oral, rather than written, misrepresentations does not preclude class certification. *In re First Alliance Mortgage Co.*, 471 F.3d 977, 991 (9th Cir. 2006) (discussing *In re Am. Cont'l Corp./Lincoln Sav. & Loan Sec. Litig.*, 140 F.R.D. 425, 430 (D. Ariz. 1992)); *Badger Mountain*, 143 F.R.D. at 698 & n.2 (discussing *Kirkpatrick v. J.C. Bradford & Co.*, 827 F.2d 718, 724 (11th Cir. 1987)). The commonality requirement is "construed permissively" such that "[a]ll questions of fact and law need not be common to satisfy the rule." *Hanlon v. Chrysler Corp.*, 150 F.3d 1011, 1019 (9th Cir. 1998); *Schwarm v. Craighead*, 233 F.R.D. 655, 660-61 (E.D. Cal. 2006). Furthermore, "Ninth Circuit deci-

sions favor a liberal use of class actions to enforce federal securities laws." *Weinberger v. Thornton*, 114 F.R.D. 599, 602 (S.D. Cal. 1986); *accord In re Adobe Sys., Inc. Sec. Litig.*, 139 F.R.D. 150, 152-53 (N.D. Cal. 1991).

The Court finds the commonality requirement is established by plaintiffs' allegations of a "common course of conduct" to defraud investors with similar misrepresentations. The record (including the SEC cease-and-desist order and the NASD letter) establishes that First Command sold SIPs by using a script that contained misrepresentations about, *inter alia*, the disciplining effect of the front-end load and the characteristics of investment alternatives. First Command sales agents testified about the importance of memorizing the sales scripts before meeting with customers. First Command's objective was a "homogenized" sales force that could give customers the same responses to the same questions throughout the country. Although defendants argue that actual sales pitches did not exactly follow the script and, therefore, the oral misrepresentations were never uniform, the Ninth Circuit's case law does not require identical misrepresentations to satisfy the commonality requirement. *First Alliance Mortgage*, 471 F.3d at 991; *Blackie*, 524 F.2d at 902. Furthermore, if the Court focuses just on the misrepresentations of the disciplining effect of the 50% front-end load and the popularity of no-load funds among speculators, all named plaintiffs were exposed to at least one misrepresentation identified by the SEC and NASD. (Bhowmik Decla. ISO Pls. Reply, ¶ 3(B)&(E).)

Plaintiffs also present a common theory of damages. Economic loss is a required element of a 10b-5 cause of action. 15 U.S.C. § 78u-4(b)(4); *Dura Pharm.*,

Inc. v. Broudo, 544 U.S. 336, 342 (2005); *Johnson v. Alijan*, — F.3d —, 2007 WL 1760751, at *3 n.13 (9th Cir. June 20, 2007). In plaintiffs' own words:

> given the lack of justification for the 50% load, the economic loss can easily and uniformly be measured as the amount taken as the 50% load during the Class Period. The subsequent payments are irrelevant to the loss calculation because but for the 10b-5 violation, this 50% sales commission would not have been paid at all[.]

(Reply ISO Class Certification, at 7.) Therefore, plaintiffs intend to recover the portion of the 50% sales load that each plaintiff paid during the class period. Plaintiffs' entitlement to these damages is another common legal issue uniting the class.

4. Typicality

"The commonality and typicality requirements . . . tend to merge" because both focus on the similarities in claims across the class. *Gen. Tel. Co. of Southwest v. Falcon*, 457 U.S. 147, 158 n.13 (1982). The typicality requirement means the named plaintiffs' claims are "reasonably coextensive" with the absent class members' claims, even if the claims are not "substantially identical." *Hanlon*, 150 F.3d at 1020; *Sepulveda*, 237 F.R.D. at 242. "The test of typicality 'is whether other members have the same or similar injury, whether the action is based on conduct which is not unique to the named plaintiffs, and whether other class members have been injured by the same course of conduct.'" *Hanon v. Dataproducts Corp.*, 976 F.2d 497, 508 (9th Cir. 1992) (quoting *Schwartz v. Harp*, 108 F.R.D. 279, 282 (C.D. Cal. 1985)); *Schwarm*, 233 F.R.D. at 661. The need to calculate individual damages does not defeat typicality. *Blackie*,

524 F.2d at 905; *Mortimore v. Fed. Deposit Ins. Corp.*, 197 F.R.D. 432, 436 (W.D. Wash. 2000).

Following the Ninth Circuit's opinion in *First Alliance*, the Court finds the present class action is based on conduct not unique to the named plaintiffs. Although no two sales meetings proceeded exactly the same way, First Command's script amounts to what *First Alliance* variously described as "a standardized sales pitch," "'centrally orchestrated strategy," and "'underlying scheme'" to defraud customers. 471 F.3d at 991 (quoting in part *Lincoln Savings*, 140 F.R.D. at 430-31). *First Alliance* further rejected the argument that Rule 23's commonality requirement demanded a showing that the subject misrepresentations were quoted verbatim from the track to each class member. *Id.* at 990. If a defendant could avoid liability for defrauding a class by rewording misrepresentations across the class, "[t]he class action mechanism would be impotent." *Id.* at 992. From this premise, the Court logically concludes that the named plaintiffs can likewise be "typical" even if those plaintiffs did not receive all of the same misrepresentations.

The same sales pitch, strategy, and scheme that injured the named plaintiffs likewise injured the absent class members. All class members received a sales presentation taken from the track and then paid a 50% sales load on their first twelve investments–after either purchasing their SIP or increasing their investment in a previously purchased SIP.

Although individualized calculations of damages do not defeat typicality, the named plaintiffs are typical only if absent class members have incurred an injury that gives rise to damages. Here, some absent class members do not "have the same or similar injury"

because First Command previously refunded all of the 50% sales charge. A First Command SIP purchaser who terminated within the first forty-five days received back the entire sales charge. (NOL, Exhibit 3, at 3 n.3.) Because these absent class members have already obtained the damages plaintiffs seek in this litigation, the named plaintiffs (who have not obtained a full refund of their sales loads[14]) are not typical of this subset of absent class members. Therefore, the Court excludes from the class those

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[14] Defendants further argue the class should also not include those individuals who terminated their plans within eighteen months of purchase. By statute, such customers are entitled to receive back at least 85% of the total payments made. 15 U. S.C. § 80a-27(d). Indeed, named plaintiffs Scott and Krystin Wagner terminated within the eighteen-month time frame and received back $4100 of the $4700 they invested in a SIP. (Kelley Decla., Exhibit A, at 18-19.) At oral argument, plaintiffs' counsel could not answer the Court's question why the class should include plaintiffs like the Wagners who received a partial refund of the money invested.

Nonetheless, at this stage, the Court finds the class should include First Command customers who terminated more than forty-five days but fewer than eighteen months after purchasing their SIP. These customers received back some but not all of the 50% sales load. For a customer who discontinues SIP contributions after eighteen months, the sales load comprises 31.6% of the amount invested. (Bullard Decla., Exhibit 1 ¶ 9.) When the investor terminates the SIP within eighteen months of purchase, the statute still allows the investment company to keep as much as 15% of the investor's total payments. Therefore, in the case of the Wagners, First Command retained a portion of the 50% sales charge they paid. Because plaintiffs argue for full reimbursement of the sales charge, the Wagners are still entitled to some recovery under plaintiffs' theory. Furthermore, the Court finds that plaintiffs seeking the return of some fraction of the sales load paid during the class period are typical of plaintiffs still seeking the return of the entire sales load paid during the class period.

individuals who paid some portion of a 50% sales load during the class period, but then received a full refund of that sales load by terminating within forty-five days.[15]

5. Adequate Representation

The Ninth Circuit applies a two-pronged test to determine whether the named plaintiffs can fairly and adequately represent the class. The first prong is "the named representatives must appear able to prosecute the action vigorously through qualified counsel[.]" *Lerwill v. Inflight Motion Pictures, Inc.*, 582 F.2d 507, 512 (9th Cir. 1978); *Kavu, Inc. v. Omnipak Corp.*, — F.R.D. —, 2007 WL 201093, at *5 (W.D. Wash. Jan. 23, 2007). The second requirement is "the representatives must not have antagonistic or conflicting interests with the unnamed members of the class." *Id.*

The Court finds plaintiffs satisfy the first prong by submitting the resumes of the five law firms currently representing the class. (Blumenthal Decla., Exhibits 1-5.) Having reviewed those resumes, the Court finds that the named plaintiffs are represented by qualified counsel with extensive experience in class action litigation. Defendants have not opposed the qualifications of plaintiffs' counsel.

Some of defendants' arguments concerning the named plaintiffs, while offered under the heading of "typicality," are better addressed under the adequacy

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[15] Plaintiffs impliedly concede the class should exclude customers who received a full refund of the sales load. (*See* Pls. Memo. ISO Class Certification, at 2.) However, plaintiffs include no explicit language in their class definition to exclude such customers. Therefore, the Court will add such language to the class definition.

of representation prong.[16] Defendants raise two broad challenges to the adequacy of named plaintiffs. First, defendants challenge whether plaintiffs who increased their investment in a SIP purchased before the class period can adequately represent absent class members who purchased a SIP for the first time during the class period. Plaintiffs purchasing before the class period cannot recover for the sales load paid on that original purchase because the five-year statute of repose bars such a suit. 28 U.S.C. § 1658(b)(2). By increasing their investment during the class period, however, these class members paid a 50% sales load on the portion of their increased investment. Mr. Robert Kimnach is an example: he purchased his SIP in 1998 and, during the class period, increased his Roth IRA contribution when Congress increased the maximum. (Kelley Decla., Exhibit Z, & Exhibit G, at 225.) Defendants argue that Mr. Kimnach cannot represent the class because he was routinely increasing his investment in response to changes in the law.

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[16] As with commonality, the uniformity of First Command's conduct in using the track to sell SIPs is the basis for the Court's finding that the plaintiffs satisfy typicality. As the Supreme Court explained in *Falcon*, the commonality and typicality inquiries overlap in their focus on the similarities in class claims. 457 U.S. at 158. Here, all the plaintiffs' claims are similar (*i.e.*, misrepresentations and omissions in the track defrauded First Command customers into paying a 50% sales load in conjunction with a SIP). Therefore, when defendants challenge the ability of certain plaintiffs to represent absent class members who are situated slightly differently (*e.g.*, increased an investment on a previously purchased SIP, continued investing in their SIP after the class period), they are really making arguments about the adequacy of the named plaintiffs to represent those absent class members. *I.e.*, the argument is whether the differences in class members' situations give rise to "antagonistic or conflicting interests".

The Court finds no antagonistic or conflicting interests between plaintiffs who increased their SIP investment during the class period and those who purchased a SIP for the first time. First Command's misrepresentations—especially the misleading characterizations of investment alternatives that customers might have chosen—could induce investors to increase their SIP investment just as much as they could induce a first-time SIP purchase. This is specifically true in Mr. Kimnach's case. At his deposition, Mr. Kimnach indeed testified that he increased his Roth IRA contribution in response to the Congressional maximum (Kelley Decla., Exhibit G, at 227), but this was not the only reason. When specifically asked whether he increased his Roth IRA contribution only because Congress increased the maximum, Mr. Kimnach responded, "it's also part of . . . not understanding or being told that I didn't have other investment options. . . . I should have and could have put that portion in a no-load IRA. But First Command had convinced me that no loads were for speculators and that wasn't the right thing to do." (NOL, Exhibit 33, at 119:2- 9.) To increase his Roth IRA contribution, Mr. Kimnach was directed to a First Command field office. (Kelley Decla., Exhibit G, at 113.) At the field office, Mr. Kimnach had a conversation with a First Command sales representative that was "similar" to his conversation with a different agent in a different city when he initially purchased the SIP. (NOL, Exhibit 33, at 115:11-17.) In fact, the second agent "came back with the exact same responses to [Kimnach's] concerns," including the representation that investment alternatives were for speculators. (*Id.*) Based on this evidence, the Court finds that Mr. Kimnach does not have "antagonistic or conflicting interests" with absent

class members who purchased a SIP during the class period. [17]

Second, defendants challenge whether plaintiffs who have terminated their SIPs can adequately represent absent class members who continue to invest in their SIPs. Defendants claim plaintiffs fail to incur an economic loss if they continue investing in their SIP long enough that the effective sales load eventually declines to a level that is not "excessive" (however one might define "excessive"). At oral argument, plaintiffs' counsel responded that, regardless of the current status of their SIP, investors should recover the 50% load because defendants' fraud was ongoing and because investors could have purchased a no-load fund instead. [18]

At this point, the Court finds that plaintiffs have made a sufficient showing of economic loss by class members with open SIP accounts: therefore, the class may include those plaintiffs. In addition to the excessive sales load paid by plaintiffs who did not continue investing in their SIPs for the full 180

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[17] In allowing Mr. Kimnach to serve as a class representative and including within the class those customers who increased their investment during the class period, the Court expects plaintiffs will limit themselves to alleged wrongdoing that took place during the class period. Plaintiffs do not rebut defendants' contention that claims preceding the class period are barred by the statute of repose. In other words, with respect to members who purchased the SIP before the class period but increased their SIP investment during the class period, the Court expects plaintiffs will only introduce evidence concerning Rule 10b-5 violations associated with the investment increase, and not the original SIP purchase.

[18] As plaintiffs' counsel phrased it at oral argument, putting more money into the fraudulent investment does not make the investor even.

months, the SEC and NASD found that all SIP investors suffered another economic loss, *i.e.*, the lost earnings over time associated with the high front-end sales charges. Because plaintiffs spent 50% of their first twelve investments on a sales charge, only the other half of those investments actually earned a return. Defendants claim this showing is "highly speculative" and, therefore, insufficient to establish economic loss. The Court reserves for summary judgment the question of whether the lost earnings over time are, as a matter of law, too speculative to satisfy Rule 10b-5's loss requirement. For the time being, plaintiffs eliminate much of the speculation by arguing for the refund of the 50% sales charge–a damages theory that does not require the Court to figure out how much the plaintiffs would have earned over time if they had invested the same amount of money in a no-load fund, rather than a SIP. The additional economic loss of incurring an excessive sales charge does not create "antagonistic or conflicting interests" with those plaintiffs who only lost earnings over time (but will remain in the SIP long enough not to pay an excessive sales load).

Defendants also specifically challenge the suitability of Kevin and Jennifer Morrison to serve as class representatives. (Defs. Opp. to Class Certification, at 23.) Mr. Morrison is currently deployed overseas and never sat for a deposition. (*Id.*) At her deposition, Mrs. Morrison testified she was "pretty distracted" during the meeting with the First Command representative because her attention was focused on their one-year-old son. (Kelley Decla., Exhibit E, at 151-52.) She never recalled seeing the First Amended Complaint. (*Id.* at 187.) Furthermore, she did not recognize the names of her attorneys or their respective law firms. (*Id.*, at 182-83.) Therefore, the Court

finds the Morrisons may not serve as class representatives because they "have little or no supervisory role in the litigation and little knowledge of the underlying facts of the law suit." *In re Daimler-Chrysler AG Sec. Litig.*, 216 F.R.D. 291, 299 (D. Del. 2003); *accord Butterworth v. Quick & Reilly, Inc.*, 171 F.R.D. 319, 322 (M.D. Fla. 1997); *Welling v. Alexy*, 155 F.R.D. 654, 659 (N.D. Cal. 1994); *Rolex Employees Retirement Trust v. Mentor Graphics Corp.*, 136 F.R.D. 658, 666 (D. Or. 1991).

6. Rule 23(b)(3)

Because all four Rule 23(a) requirements are satisfied, the Court turns to Rule 23(b)(3) to determine whether common questions predominate over individual questions, and whether a class action is the superior method of adjudicating this controversy.

a. Predominance

Defendants' primary argument in opposition to class certification is that individual issues of reliance predominate over any common questions of law or fact.[19] (Defs. Opp. to Class Certification, at 1.) A

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[19] Defendants raise novel arguments that class certification would violate the Rules Enabling Act, the Seventh Amendment right to trial by jury, and the due process clause. (Defs. Opp. to Class Certification, at 11-13.) Under the Rules Enabling Act, a procedural rule "shall not abridge, enlarge or modify any substantive right." 28 U. S.C. § 2072(b). From this statute, and without any supporting case law, First Command claims the right to present evidence on the specific content of each investor's individual meeting with a First Command representative. First Command also claims that class certification would abridge absent class members' right to trial by jury. For this proposition, defendants cite out-of-circuit authorities discussing the heightened standards for pleading scienter under the latest amendments to the securities laws, rather than cases pertaining

cause of action under Rule 10b-5 requires the plaintiffs' justifiable reliance on the misrepresentation or omission. *Binder v. Gillespie*, 184 F.3d 1059, 1063 (9th Cir. 1999). Defendants claim that, where there is no presumption of reliance in a Rule 10b-5 case, individual questions of reliance automatically defeat class certification. Defendants rely on the following language from the Supreme Court: "[r]equiring proof of individualized reliance from each member of the proposed plaintiff class effectively would have prevented respondents from proceeding with a class action, *since individual issues then would have overwhelmed the common ones.*" *Basic v. Levinson*, 485 U.S. 224, 242 (1988) (emphasis added). In *Basic*, the Supreme Court adopted the "fraud-on-the-market" theory[20] as a rebuttable presumption in Rule 10b-5 cases. Because the fraud-on-the-market presumption applies only to cases involving a security's price (not this case), plaintiffs cannot benefit from the presumption.

At oral argument, plaintiffs' primary argument on the reliance issue was to urge the adoption of the

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to class certification. Finally, on the basis of some minor dicta in a Fifth Circuit case, First Command alleges a classwide jury verdict would violate the due process clause by taking property without allowing First Command to defend itself properly. The Court finds all these arguments are meritless, because no federal appellate court has adopted them in the context of class certification in a securities case.

[20] Briefly summarized, "fraud-on-the-market" theory is the concept that "persons who had traded [a company's] shares had done so in reliance on the integrity of the price set by the market, but because of [defendants'] material misrepresentations that price had been fraudulently depressed." *Basic*, 485 U.S. at 245.

Affiliated Ute presumption, which the Supreme Court has described as follows:

> Under the circumstances of [a] case, involving primarily a failure to disclose, positive proof of reliance is not a prerequisite to recovery. All that is necessary is that the facts withheld be material in the sense that a reasonable investor might have considered them important in the making of this decision.

Affiliated Ute Citizens of Utah v. United States, 406 U.S. 128, 153-54 (1972). According to the Ninth Circuit, the *Affiliated Ute* presumption "should not be applied to cases that allege both misstatements and omissions unless the case can be characterized as one that primarily alleges omissions." *Binder*, 184 F.3d at 1064. A case does not primarily allege omissions where "the[] claims are best characterized as either affirmative misrepresentations or 'mixed claims[.]'" *Poulos v. Caesars World, Inc.*, 379 F.3d 654, 666 (9th Cir. 2004); *accord Johnson v. HBO Film Mgmt., Inc.*, 265 F.3d 178, 192 (3d Cir. 2001); *Joseph v. Wiles*, 223 F.3d 1155, 1163 (10th Cir. 2000). Defendants describe the present action as "fundamentally a misrepresentation case[.]" (Defs. Opp. to Class Certification, at 10.) At oral argument, defendants asserted that any alleged omission in the consolidated SAC is merely the "obverse" of a misrepresented fact. (*See* Kelley Decla., Exhibit P.)

The Court declines to apply the *Affiliated Ute* presumption in this case. The Bullard report concentrates its analysis on defendant's "misleading sales practices" and includes no separate section on omissions. (*See* Bullard Decla., Exhibit 1, at 5.) At best, plaintiffs' allegations are predominantly "mixed claims," *Poulos*, 379 F.3d at 666, and the purported

omission is simply the "fail[ure] to disclose that the allegedly misleading fact was untrue." *Johnson*, 265 F.3d at 193. If the presumption applied in this case, it would "swallow the reliance requirement almost completely." *Joseph*, 223 F.3d at 1163.

Nonetheless, the Court finds that plaintiffs have satisfied the reliance element, on the basis of the Ninth Circuit's recent opinion in *First Alliance* and the district court opinion in *Lincoln Savings* that the Ninth Circuit endorsed. Defendants claim that the *First Alliance* court found reliance by applying a presumption under California state law. (Defs. Opp. to Class Certification, at 5.) This claim is wrong: the word "presumption" does not appear in the body of the opinion. Instead, the lender in *First Alliance* argued that reliance was not satisfied because the borrowers signed documents that contradicted the oral misrepresentations. 471 F.3d at 992. The Ninth Circuit rejected that argument because "it was by design that [plaintiffs] did not understand that the loan documents told a different story." *Id.* California law did not impose a presumption of reliance; instead, it required that the misrepresentation be a "substantial factor" in inducing plaintiffs' action. *Id.*

Defendants claim *First Alliance* is distinguishable because that class action arose under state fraud law, but this case arises under Rule 10b-5. Defendants' attempt to assign talismanic significance to reliance in Rule 10b-5 cases fails in light of *First Alliance*'s extensive discussion of *Lincoln Savings*, itself a Rule

10b-5 case. The *Lincoln Savings* court found that reliance was satisfied because, *inter alia*[21]:

> a showing that the sales presentations were uniformly patterned on a known model provides certitude that material misrepresentations were a causative factor in each plaintiffs' decision. Thus, a class action may be maintained where plaintiffs can establish that the sales agents' representations did not vary in material respects.

140 F.R.D. at 430; *see Schaefer v. Overland Express Family of Funds*, 169 F.R.D. 124, 128-30 (S.D. Cal. 1996) (refusing to allow reliance issues to prevent class certification involving oral misrepresentations "presented in a fairly similar form," because further discovery would allow plaintiffs to select the particular theory or presumption of reliance they would rely on). In effect, the *Lincoln Savings* court used the uniformity of the misrepresentations to presume the plaintiffs relied on those misrepresentations in their investment decisions. Likewise, here, First Command's misrepresentations were sufficiently similar to satisfy the commonality and typicality requirements of Rule 23(a), and to give rise to a presumption that plaintiffs relied on those misrepresentations in deciding to purchase a SIP or increase their investment in a previously purchased SIP.

By acknowledging the reliance requirement and determining that plaintiffs have satisfied that requirement, the Court's findings are faithful to the Supreme Court's holding in *Basic*. The Court is not persuaded by defendants' argument that "individual

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[21] The district court also applied presumptions of reliance based on "fraud in the offering" and "fraud in the regulatory process". *Lincoln Savings*, 140 F.R.D. at 431, 433.

reliance is required in this case." (Defs. Opp. to Class Certification, at 5.) To the contrary, *Basic* explained "[t]here is, however, more than one way to demonstrate the causal connection" between an investment company's misrepresentation and an investor's injury, *i.e.*, reliance. 485 U.S. at 243. The opinions in *First Alliance* and *Lincoln Savings* make clear that, within the Ninth Circuit, plaintiffs can establish a presumption of reliance by means of sufficiently uniform oral misrepresentations in a marketing script. Nothing in *Basic* forecloses the creation of a presumption. Indeed, *Basic* conceded that, as securities markets evolved into large-scale mechanisms for transactions involving millions of shares, "our understanding of Rule 10b-5's reliance requirement must encompass these differences." 485 U.S. at 244. Similarly, the reliance requirement must encompass the rise of sophisticated marketing strategies which rely on communicating similar misrepresentations to a large class of investors.[22] With a presumption of reliance established, common questions of law and fact predominate over individual questions in this action.

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[22] Because the *First Alliance/Lincoln Savings* presumption is sufficient to establish reliance in this case, the Court declines to address whether reliance can be presumed based on fraud in the regulatory process. Plaintiffs argued for this presumption for the first time in their reply, and defendants did not anticipate the argument in their opposition. Furthermore, at oral argument, the Court declined defendants' invitation to argue why that presumption did not apply in this case. As necessary, the Court will revisit the applicability of the presumption of fraud in the regulatory process (*e.g.*, in a subsequent motion for summary judgment).

b. Superior Method of Adjudication

The Court also finds that a class action is the superior method for fair and efficient adjudication of this controversy. If the approximately 100,000 plaintiffs each pursued their claims individually, they would "clog[] the federal courts with innumerable individual suits litigating the same issues repeatedly." *Dukes*, 474 F.3d at 1244. Although plaintiffs assert complex claims which will be very costly to litigate, each individual plaintiff has a relatively small amount at stake. Furthermore, the Ninth Circuit has stated a preference for resolving securities claims via class action as a means of deterring fraud. *Harris*, 329 F.2d at 913; *accord First Alliance*, 471 F.3d at 990; *Blackie*, 524 F.2d at 902; *Adobe Sys.*, 139 F.R.D. at 152-53; *Weinberger*, 114 F.R.D. at 602.

CONCLUSION

The named plaintiffs are not typical of class members who received a full refund of the entire sales charge. Because the named plaintiffs otherwise satisfy the requirements of Federal Rule of Civil Procedure 23(a) and (b)(3), the Court GRANTS IN PART plaintiffs' motion for class certification. The Court CERTIFIES a class defined as follows:

> all persons who, during the period from January 31, 2000 through December 31, 2004, made a SIP payment so as to be charged a 50% sales charge on the money placed at that time into the SIP through First Command and still owned the SIP on December 15, 2004, and who did not terminate within forty-five (45) days of purchasing the SIP so as to receive a full refund of the sales charge.

Mr. Kevin and Mrs. Jennifer Morrison MAY NOT SERVE as class representatives because they cannot

adequately represent the class. All other plaintiffs currently named in the Complaint MAY SERVE as class representatives.

Within fourteen (14) calendar days of the date this Order is docketed, plaintiffs SHALL LODGE a Proposed Order defining the class claims, issues, and defenses, and appointing class counsel. *See* Fed. R. Civ. P. 23(c)(1)(B). Plaintiffs MAY FILE simultaneously a brief, not to exceed ten (10) pages, in support of the Proposed Order.

Portions of the Bullard Report rely on speculation about the number of dormant or inactive First Command accounts and make conclusions about legal violations not relevant to this case. The remainder of the Bullard Report is useful in the Court's evaluation of whether plaintiffs satisfied the class certification requirements. Therefore, the Court GRANTS IN PART and DENIES IN PART defendants' motion to strike the Bullard Report.

The Court DENIES defendants' motion to strike references to the January 2000 NASD letter in the complaint. Instead, the Court GRANTS plaintiffs' request for leave to amend the complaint to correct the scrivener's error.

Defendants' motion to strike the complaint's class allegations as to the parent company and the individual defendants is untimely and inappropriate for resolution in conjunction with a motion for class certification. The Court DENIES this motion, without prejudice to renew the substantive legal arguments in a motion for summary judgment.

The Court DENIES defendants' motion to strike the complaint's class allegations. The Court *sua*

sponte GRANTS plaintiffs leave to amend the complaint to conform the class definition to this Order.

IT IS SO ORDERED.

DATED: July 30, 2007

/s/ Irma E. Gonzalez
IRMA E. GONZALEZ, Chief Judge
United States District Court

APPENDIX D

UNITED STATES CODE SERVICE

CONSTITUTION OF THE UNITED STATES OF AMERICA

AMENDMENT 5

Criminal actions—Provisions concerning—Due process of law and just compensation clauses.

No person shall be held to answer for a capital, or otherwise infamous crime, unless on a presentment or indictment of a Grand Jury, except in cases arising in the land or naval forces, or in the Militia, when in actual service in time of War or public danger; nor shall any person be subject for the same offence to be twice put in jeopardy of life or limb; nor shall be compelled in any criminal case to be a witness against himself, nor be deprived of life, liberty, or property, without due process of law; nor shall private property be taken for public use, without just compensation.

APPENDIX E

UNITED STATES CODE SERVICE

CONSTITUTION OF THE UNITED STATES OF AMERICA

AMENDMENT 7

Trial by jury in civil cases.

In Suits at common law, where the value in controversy shall exceed twenty dollars, the right of trial by jury shall be preserved, and no fact tried by a jury, shall be otherwise re-examined in any Court of the United States, than according to the rules of the common law.

APPENDIX F

UNITED STATES CODE SERVICE

TITLE 28.—JUDICIARY AND JUDICIAL PROCEDURE

PART V.—PROCEDURE

CHAPTER 131.—RULES OF COURTS

§ 2072. Rules of procedure and evidence; power to prescribe

(a) The Supreme Court shall have the power to prescribe general rules of practice and procedure and rules of evidence for cases in the United States district courts (including proceedings before magistrates thereof) and courts of appeals.

(b) Such rules shall not abridge, enlarge or modify any substantive right. All laws in conflict with such rules shall be of no further force or effect after such rules have taken effect.

(c) Such rules may define when a ruling of a district court is final for the purposes of appeal under section 1291 of this title [28 USCS § 1291].

APPENDIX G

CODE OF FEDERAL REGULATIONS

TITLE 17—COMMODITY AND SECURITIES EXCHANGES

CHAPTER II—SECURITIES AND EXCHANGE COMMISSION

PART 240—GENERAL RULES AND REGULATIONS, SECURITIES EXCHANGE ACT OF 1934

SUBPART A—RULES AND REGULATIONS UNDER THE SECURITIES EXCHANGE ACT OF 1934

MANIPULATIVE AND DECEPTIVE DEVICES AND CONTRIVANCES

§ 240.10b-5 Employment of manipulative and deceptive devices.

It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce, or of the mails or of any facility of any national securities exchange,

(a) To employ any device, scheme, or artifice to defraud,

(b) To make any untrue statement of a material fact or to omit to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading, or

(c) To engage in any act, practice, or course of business which operates or would operate as a fraud or deceit upon any person,

in connection with the purchase or sale of any security.

APPENDIX H

UNITED STATES CODE SERVICE

FEDERAL RULES OF CIVIL PROCEDURE

IV.—PARTIES

Rule 23. Class Actions [Caution: For amendment effective December 1, 2007, see prospective amendment note below.]

(a) Prerequisites to a Class Action. One or more members of a class may sue or be sued as representative parties on behalf of all only if (1) the class is so numerous that joinder of all members is impracticable, (2) there are questions of law or fact common to the class, (3) the claims or defenses of the representative parties are typical of the claims or defenses of the class, and (4) the representative parties will fairly and adequately protect the interests of the class.

(b) Class Actions Maintainable. An action may be maintained as a class action if the prerequisites of subdivision (a) are satisfied, and in addition:

(1) the prosecution of separate actions by or against individual members of the class would create a risk of

(A) inconsistent or varying adjudications with respect to individual members of the class which would establish incompatible standards of conduct for the party opposing the class, or

(B) adjudications with respect to individual members of the class which would as a practical matter be dispositive of the interests of the other members not parties to the adjudications or substantially impair or impede their ability to protect their interests; or

(2) the party opposing the class has acted or refused to act on grounds generally applicable to the class, thereby making appropriate final injunctive relief or corresponding declaratory relief with respect to the class as a whole; or

(3) the court finds that the questions of law or fact common to the members of the class predominate over any questions affecting only individual members, and that a class action is superior to other available methods for the fair and efficient adjudication of the controversy. The matters pertinent to the findings include: (A) the interest of members of the class in individually controlling the prosecution or defense of separate actions; (B) the extent and nature of any litigation concerning the controversy already commenced by or against members of the class; (C) the desirability or undesirability of concentrating the litigation of the claims in the particular forum; (D) the difficulties likely to be encountered in the management of a class action.

(c) Determining by Order Whether to Certify a Class Action; Appointing Class Counsel; Notice and Membership in Class; Judgment; Multiple Classes and Subclasses.

(1)(A) When a person sues or is sued as a representative of a class, the court must—at an early practicable time—determine by order whether to certify the action as a class action.

(B) An order certifying a class action must define the class and the class claims, issues, or defenses, and must appoint class counsel under Rule 23(g).

(C) An order under Rule 23(c)(1) may be altered or amended before final judgment.

(2)(A) For any class certified under Rule 23(b)(1) or (2), the court may direct appropriate notice to the class.

(B) For any class certified under Rule 23(b)(3), the court must direct to class members the best notice practicable under the circumstances, including individual notice to all members who can be identified through reasonable effort. The notice must concisely and clearly state in plain, easily understood language:

- the nature of the action,
- the definition of the class certified,
- the class claims, issues, or defenses,
- that a class member may enter an appearance through counsel if the member so desires,
- that the court will exclude from the class any member who requests exclusion, stating when and how members may elect to be excluded, and
- the binding effect of a class judgment on class members under Rule 23(c)(3).

(3) The judgment in an action maintained as a class action under subdivision (b)(1) or (b)(2), whether or not favorable to the class, shall include and describe those whom the court finds to be members of the class. The judgment in an action maintained as a class action under subdivision (b)(3), whether or not favorable to the class, shall include and specify or describe those to whom the notice provided in subdivision (c)(2) was directed, and who have not requested exclusion, and whom the court finds to be members of the class.

(4) When appropriate (A) an action may be brought or maintained as a class action with respect to particular issues, or (B) a class may be divided into subclasses and each subclass treated as a class, and the provisions of this rule shall then be construed and applied accordingly.

(d) Orders in Conduct of Actions. In the conduct of actions to which this rule applies, the court may make appropriate orders: (1) determining the course of proceedings or prescribing measures to prevent undue repetition or complication in the presentation of evidence or argument; (2) requiring, for the protection of the members of the class or otherwise for the fair conduct of the action, that notice be given in such manner as the court may direct to some or all of the members of any step in the action or of the proposed extent of the judgment, or of the opportunity of members to signify whether they consider the representation fair and adequate, to intervene and present claims or defenses, or otherwise to come into the action; (3) imposing conditions on the representative parties or on intervenors; (4) requiring that the pleadings be amended to eliminate therefrom allegations as to representation of absent persons, and that the action proceed accordingly; (5) dealing with similar procedural matters. The orders may be combined with an order under Rule 16, and may be altered or amended as may be desirable from time to time.

(e) Settlement, Voluntary Dismissal, or Compromise.

(1)(A) The court must approve any settlement, voluntary dismissal, or compromise of the claims, issues, or defenses of a certified class.

(B) The court must direct notice in a reasonable manner to all class members who would be bound by a proposed settlement, voluntary dismissal, or compromise.

(C) The court may approve a settlement, voluntary dismissal, or compromise that would bind class members only after a hearing and on finding that the settlement, voluntary dismissal, or compromise is fair, reasonable, and adequate.

(2) The parties seeking approval of a settlement, voluntary dismissal, or compromise under Rule 23(e)(1) must file a statement identifying any agreement made in connection with the proposed settlement, voluntary dismissal, or compromise.

(3) In an action previously certified as a class action under Rule 23(b)(3), the court may refuse to approve a settlement unless it affords a new opportunity to request exclusion to individual class members who had an earlier opportunity to request exclusion but did not do so.

(4)(A) Any class member may object to a proposed settlement, voluntary dismissal, or compromise that requires court approval under Rule 23(e)(1)(A).

(B) An objection made under Rule 23(e)(4)(A) may be withdrawn only with the court's approval.

(f) Appeals. A court of appeals may in its discretion permit an appeal from an order of a district court granting or denying class action certification under this rule if application is made to it within ten days after entry of the order. An appeal does not stay proceedings in the district court unless the district judge or the court of appeals so orders.

(g) Class Counsel.

(1) *Appointing Class Counsel.*

(A) Unless a statute provides otherwise, a court that certifies a class must appoint class counsel.

(B) An attorney appointed to serve as class counsel must fairly and adequately represent the interests of the class.

(C) In appointing class counsel, the court

(i) must consider:

- the work counsel has done in identifying or investigating potential claims in the action,
- counsel's experience in handling class actions, other complex litigation, and claims of the type asserted in the action,
- counsel's knowledge of the applicable law, and
- the resources counsel will commit to representing the class;

(ii) may consider any other matter pertinent to counsel's ability to fairly and adequately represent the interests of the class;

(iii) may direct potential class counsel to provide information on any subject pertinent to the appointment and to propose terms for attorney fees and nontaxable costs; and

(iv) may make further orders in connection with the appointment.

(2) *Appointment Procedure.*

(A) The court may designate interim counsel to act on behalf of the putative class before determining whether to certify the action as a class action.

(B) When there is one applicant for appointment as class counsel, the court may appoint that appli cant only if the applicant is adequate under Rule 23(g)(1)(B) and (C). If more than one adequate applicant seeks appointment as class counsel, the court must appoint the applicant best able to represent the interests of the class.

(C) The order appointing class counsel may include provisions about the award of attorney fees or nontaxable costs under Rule 23(h).

(h) Attorney Fees Award. In an action certified as a class action, the court may award reasonable attorney fees and nontaxable costs authorized by law or by agreement of the parties as follows:

(1) *Motion for Award of Attorney Fees.* A claim for an award of attorney fees and nontaxable costs must be made by motion under Rule 54(d)(2), subject to the provisions of this subdivision, at a time set by the court. Notice of the motion must be served on all parties and, for motions by class counsel, directed to class members in a reasonable manner.

(2) *Objections to Motion.* A class member, or a party from whom payment is sought, may object to the motion.

(3) *Hearing and Findings.* The court may hold a hearing and must find the facts and state its conclusions of law on the motion under Rule 52(a).

(4) *Reference to Special Master or Magistrate Judge.* The court may refer issues related to the amount of the award to a special master or to a magistrate judge as provided in Rule 54(d)(2)(D).